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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the Court of Appeal of California,
First Appellate District

Jurisdictional Statement

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On Appeal from the Court of Appeal of California,
First Appellate District

Jurisdictional Statement

This is an appeal from a state court decision holding that the business of Chase Brass and Copper Co., Incorporated, is unitary with the copper operations of its parent, Kennecott Copper Corporation, and with Kennecott Sales Corporation and Kennecott Wire and Cable Co. Appellant submits this Statement to show that this Court has jurisdiction of the appeal and that substantial questions are presented.

OPINIONS BELOW

The original trial court decision of the Superior Court in and for the State of California, for the City and County of San Francisco, in favor of plaintiff therein and appellant herein is found in its findings of fact and conclusions of law and judgment, which are set forth in Appendix A; the decision is unreported. The first opinion of the Court of Appeal of California, First Appellate District, affirming in part and reversing in part the first trial court decision, is reported at 10 Cal App. 3d 496, 95 Cal. Rptr. 805 (hereinafter Chase I) and is set forth in Appendix B. The Court of Appeal decision in Chase I reserved some issues for decision and remanded the entire proceeding to the Superior Court for further proceedings. The California Supreme Court denied appellant's petition for hearing on June 24, 1970, and this Court dismissed appellant's appeal "for want of jurisdiction", 400 U.S. 961.

The unreported decision on remand after trial in favor of the defendant Franchise Tax Board, State of California, rendered by the Superior Court, State of California, City and County of San Francisco, is found in its conclusions of law and judgment, which are set forth in Appendix C. The decision from which this appeal is taken is the opinion of the Court of Appeal of California, First Appellate District, affirming the second decision of the trial court, on remand, and is reported at 70 Cal App. 3d 457, and 138 Cal. Rptr. 901 (hereinafter Chase II), and this opinion is set forth in Appendix D. Cross petitions for rehearing were denied by the Court of Appeal and cross petitions for hearing in the California Supreme Court were denied by that Court on August 11, 1977. Notice of Appeal (Appendix E) was filed in the California Court of Appeal on September 12, 1977.

JURISDICTION

This suit for refund of state corporate franchise taxes was brought pursuant to California Revenue and Taxation Code Section 26102 and California Code of Civil Procedure Section 401. At the first trial the California Superior Court held that Chase Brass and Copper Co., Incorporated (hereinafter Chase) was not unitary with its parent corporation, Kennecott Copper Co. (hereinafter Kennecott) or any other of Kennecott's subsidiaries, contrary to the assertions of the defendant, Franchise Tax Board, State of California (hereinafter Board). Chase's complaint, in conformance with its claim for refund, alleged that the Board's asserted unitary consolidation[1] and denial of claim for refund was "erroneous, contrary to federal and California law, and unconstitutional under both the Commerce Clause and the Due Process Clause of the United States Constitution".[2] The Superior Court found in favor of Chase without having recourse to the constitutional issues raised by Chase.

The issues not reached were enumerated in the trial court's Conclusions of Law (Appendix A, pp. 8-9); all of them were raised in the briefs before the Court of Appeal. The Court of Appeal reversed the judgment below in part and remanded for further proceedings (in Chase I). It did not explicitly answer the arguments that the result it reached was repugnant to the federal Constitution. The Petition for Rehearing to the Court of Appeal requested the court to rule explicitly instead of tacitly on the issues arising under the Due Process and Commerce Clauses. In its

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1. Asserted under the authority of California Revenue & Taxation Code Secs. 25101, 25105, the provisions of which are set forth in Appendix F.

2. The provisions of the U.S. Constitution on which appellant relied and relies are set forth in Appendix F.

opinion on denial of rehearing the Court reiterated its remand order and refused to discuss the constitutional arguments. Chase's arguments under the Due Process and Commerce clauses were again raised in its timely filed Petition for Hearing in the California Supreme Court, which was denied without opinion on June 24, 1970. Chase timely filed Notice of Appeal in the California Court of Appeal and timely filed its Jurisdictional Statement in support of Appeal in this Court. The appeal was denied on December 3, 1970, (400 U.S. 961) "for want of jurisdiction".[3]

The trial on remand in the Superior Court of California, City and County of San Francisco, was held on October 11, 1972, and a further evidentiary proceeding was held September 25, 1975. Chase continued to assert the arguments for the constitutional limitations on the Board's method of taxation. The decision of the trial court on remand, partly favorable to Chase on the scope of the remand but in all other respects favoring the defendant, Franchise Tax Board, was timely appealed by both parties. Chase again raised the constitutional issues it had asserted from the inception of the case. The Court of Appeal affirmed the trial court judgment on June 7, 1977, and denied cross-petitions for rehearing on July 7, 1977. Both parties filed petitions for hearing in the California Supreme Court, and Chase's petition was based principally on the same constitutional issues which are raised herein. Both petitions for

3. "The appeal is dismissed for want of jurisdiction. Treating the papers whereon the appeal was taken as a petition for certiorari, certiorari is denied." The language is that used by the Court when it has no jurisdiction over a state court decision which is not final, as was the case with the Chase I decision. 28 USC Section 1257; Stern & Gressman (4th Ed.) Secs. 3.7, 3.12; pp. 93-94, 100-103; Annotation, State Courts-Finality, 29 L.Ed.2d 872, §§ 6, 7, pp. 884-889, and cases cited therein.

hearing were denied August 11, 1977, and Chase filed its Notice of Appeal, dated September 8, 1977, in the California Court of Appeal on September 12, 1977.

Jurisdiction to hear this appeal is conferred on this Court by 28 U.S.C. § 1257 (2) and is supported by decisions in *Norfolk & Western Railroad Co. v. Missouri Tax Comm.* 390 U.S. 317 (1968); *Boston Stock Exchange v. State Tax Comm.* 429 U.S. 318, (1977); and *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The Commerce Clause of the Constitution of the United States (Art. I, § 8, cl. 3) and the Due Process Clause of the Fourteenth Amendment are set forth in Appendix F.

The pertinent sections of the California Revenue and Taxation Code, sections 25101, and 25105, are also set forth in Appendix F. There is no official publication of California codes to which volume and page reference can be given.

QUESTIONS PRESENTED

(1) Does the statement of this Court in *International Harvester Corp. v. Evatt,* 329 U.S. 416 (1947), that "rough approximation rather than precision is sufficient" in the apportionment of taxable values mean that there are no effective standards for measuring the extraterritorial effect of an apportionment of income to test its compliance with the Due Process and Commerce Clauses?

(2) Do the Commerce and Due Process Clauses of the United States Constitution permit a state to impose on a corporation doing business there selling goods it manufactured elsewhere and imported in interstate commerce, a franchise tax measured by a portion of the income of its parent corporation, where the parent corporation does no

business in the taxing state, but sells a raw material to that subsidiary in another state at a nonpreferential price, and where the nature of the parent's business produces a margin of profit greatly in excess of any that could be realized by any corporation in the subsidiary's industry, thus necessarily extending the state tax to income earned by the parent in other states?

(3) Does the Commerce Clause permit a state having taxing jurisdiction over a selling corporation to impose multiple taxation on interstate commerce by extending its tax to the income of the parent corporation, which is a mining corporation not doing business in the state taxing the selling corporation, and by refusing to take into account the system of taxation established by the states where the mining corporation operates, where the combination of methods creates multiple taxation?

(4) May a state which taxes the manufacturing subsidiary of a mining enterprise which itself does not do business in the taxing state, ignore a loss suffered in one of the taxable years by the subsidiary because a flood eliminated production at its principal factory for 9 months, and compel the payment of a franchise tax measured by some of the net income of the parent mining corporation and earned by the latter during the period when the subsidiary was operating unprofitably due to the flood, consistently with the Due Process Clause and its judicial interpretation that a state may not tax income earned outside its jurisdiction, and the Commerce Clause, requiring that the business of a corporation conducted in interstate commerce within and without the taxing state be measured in a manner to prevent multiple taxation of the same income?

(5)(a) May a state having jurisdiction to impose a franchise tax on a corporation discriminate against it because

all of its stock is owned by another corporation, in the absence of any preferential pricing or other abuse of control by the parent corporation, which itself does no business within and hence cannot be taxed by the taxing state, without offending both the Commerce Clause and the Due Process Clause?

(5)(b) Do those constitutional provisions permit a state to discriminate against a foreign corporation operating within and without its borders, by requiring its consolidation with its parent corporation which does not do business within the taxing state, when the state does not require or permit such consolidation if both corporations do business exclusively within the taxing state?

(6) Does a state observe due process requirements when it uses a three factor formula which it weights in its own favor by: (a) placing local property in the property factor at recent cost price which approximates present value and uses historical cost for valuing out-of-state mines which represents only one-third of their present value, and (b) by eliminating from out-of-state payroll and property substantial amounts not employed to produce gold, silver, and molybdenite, the income from which was excluded from unitary income, but was employed to produce the copper from which the income taxed was derived?

STATEMENT OF THE CASE

The history of this case and statement of stages at which the Federal questions were raised are set forth in the jurisdiction section, above pp. 3-5.

The facts of this case were not fully stated in the opinion of the Court of Appeal, and are here supplemented by references to the Findings of Fact (Appendix A) and por-

tions of the Stipulation of Facts (Appendix G).[4] The record below also included the uncontradicted testimony (See App. 1-5) reflected in part in the Findings.

Chase, a Connecticut corporation organized in 1909, manufactures brass, bronze, and copper rod, wire, sheet, and tube. Manufacturing is done in plants located in Connecticut and Ohio. Chase is qualified to do business and is doing business in 25 states, including California. In 1929, its stock was acquired and has been since owned by Kennecott Copper Corporation (Kennecott). (App. 60)

The parties stipulated:

> "[T]he President of Chase . . . directed the affairs of Chase. His time and attention were given to Chase: he was not responsible for the business operations of Kennecott or of any of Kennecott's other subsidiaries. He had a complete staff and line organization under his direction which carried out the fabricating, pricing, selling, warehousing, purchasing, record keeping, advertising, employee relations, and all other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale." (App. 64.)
>
> "[D]ay-to-day operations of Kennecott were the concern of its executives and were handled by the general managers of the divisions. The day-to-day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various sub-ordinate employees of the subsidiaries. . . ." (App. 63)

Both the president and executive vice president of Chase came to Chase from independent companies. (App. 71.)

The taxes at issue in this appeal involve the income years 1954, 1955 and 1956. They are upon Chase's privilege of exercising its franchise within California and are to be

4. Hereafter appendix references are to App., followed by the page number.

measured by Chase's net income derived from California. Rev. & Tax. Code § 23151.

Where a corporation's net income is derived from sources within and without the state, California requires apportionment to determine the income derived from sources within California. Rev. & Tax. Code § 25101. In its California tax return, Chase reported its entire net income as it did for federal income tax purposes, and computed its California income on the basis of the traditional three-factor apportionment formula, which is the average of the ratios of property, payroll and sales within the state to those outside the state. (App. 12.) For neither state nor federal tax purposes did Chase or Kennecott, the parent, file consolidated returns. (App. 74.)

The Franchise Tax Board redetermined Chase's California income by consolidating its income with that of Kennecott, Kennecott Sales Corporation (Kennecott Sales), Kennecott Wire and Cable Co. (Kennecott Wire), Bear Creek Mining Co. (Bear Creek) and Braden Copper Co. (Braden). (App. 12.) The effect of this redetermination was to multiply both Chase's California income and its overall corporate income thirteen-fold. The Superior Court disapproved the consolidation and gave judgment for appellant. The Court of Appeal sustained the consolidation of Chase with Kennecott, Kennecott Sales and Kennecott Wire, but not with Braden and Bear Creek. (App. 21.)

Kennecott, a New York corporation, mines, smelts and refines copper, gold, silver, and molybdenite. It does no business in California. (App. 13, 60.) Kennecott, through Kennecott Sales, sells fungible copper to numerous fabricators, at the same price for all. (App. 74.) Approximately 20% of its total production of copper is sold to Chase and 4% to Kennecott Wire; the remaining 76% is sold to other

customers. (App. 69.) Chase's two major competitors together purchased approximately as much of Kennecott's output of copper as Chase did, representing between 50% and 60% of their copper requirements. (App. 6.) Chase purchased approximately 80-84% of its copper from Kennecott, at the same price and terms as all other Kennecott customers. (App. 14.)

Kennecott Sales, a New York corporation, took over in 1934 the sales activity theretofore assigned by Kennecott and Braden to an independent sales agency. It makes no sales in California. (App. 4, 13, 67.) Kennecott Sales charges Kennecott a commission on each sale (App. 13), and sells the copper to Chase and others at the going market price for fungible refined copper (App. 21, 74). For the years at issue, Kennecott Sales paid to the State of New York a tax upon its entire corporate net income and New York did not allocate any part of that net income to other states. (App. 75.)

Kennecott Wire, a Rhode Island corporation, manufactures copper rod, wire and cable for transmission of electricity. Its stock was purchased by Kennecott from outsiders in 1935. It uses refined copper which it purchases from Kennecott Sales. Its sales operations in California are largely handled by Chase. Kennecott Wire did no business in California during the relevant years. (App. 13-14, 60-61, 62-63.) The president of Kennecott Wire was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He had a complete line and staff organization, which under his direction, carried out the fabricating, pricing, selling (except as for that part handled by Chase), purchasing, record keeping, employee relations, and all other customary and necessary functions of a modern corporation engaged in fabricating and selling

on a wide scale. (App. 64-65.) For the years at issue, Kennecott Wire paid to the State of Rhode Island tax on its entire corporate net income and Rhode Island did not allocate any part of that net income to other states. (App. 75)[5]

The trial court, on the basis of evidence said by the Court of Appeal to be uncontradicted (App. 15), found as ultimate facts (App. 7):

> "The apportionment formula used by defendant operates to assign to Chase income earned by the income earning activities of Kennecott, Braden, and Kennecott Sales....
>
> "Chase's business activities are not so interrelated with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected on each's separate books of accounts. Chase's income and expenses all arise as a result of arm's length dealing at market prices. The contacts between Chase and the other corporations were of extremely minor significance in relation to the income-earning activity of each corporation. The only substantial business contact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent market place.

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5. Braden, a Maine corporation, operated copper mines in Chile. Braden sold fire refined copper. It was a Western Hemisphere Trade Corporation for federal income tax purposes and ordinarily sold only to the Chilean government or on the world market. In the years at issue, due to United States copper shortages, it did sell, through Kennecott Sales, in this country. Chase was a buyer. (App. 13.)

Bear Creek, a Delaware corporation, explored for metals in California during the years at issue but made no significant discoveries. It is the third company in the mining group composed of Kennecott, Braden, and Bear Creek. (App. 13.)

The board included Braden and Bear Creek in the consolidation, but both courts excluded them. (App. 21.) The status of these two corporations is not now an issue.

> "Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership."

It held that on these facts Chase was not unitary with any other corporation (App. 8), and rendered judgment for Chase. (App. 10.)

The Court of Appeal reversed the decision of the trial court in part, holding that under local law the ultimate conclusion of non-unitary character was one of law, with which it disagreed, and that the combined reporting of Chase, Kennecott Wire, Kennecott Sales and Kennecott was proper (App. 17-21), because:

1. Kennecott does "minor" purchasing of some supplies for Chase;

2. Although Chase maintains its own trade name, trademark, advertising program and budget, its advertisements often contain a statement that Chase is a subsidiary of Kennecott;

3. Although Chase and Kennecott keep separate books of account, the two use the same accounting firm (the court mistakenly said that they also file consolidated tax returns, though the stipulated fact (App. 74) is to the contrary);

4. Although Chase has its own legal staff and on occasion employs its own outside counsel, the presentation of the protest of Chase before the Franchise Tax Board in this case was handled by Kennecott employees (the Court of Appeal did not refer to testimony that the reason Kennecott had its employees handle the protest was that it felt its income was being taxed;

5. In 1955 Kennecott made a loan to Chase, in the amount of ten million dollars, for the rehabilitation of a plant severely damaged by flood, although the prime bank rate of interest was charged and the loan including interest was repaid within four years (the Court of Appeal did not refer to the fact that the effect of the flood was to close the plant for portions of two of the years involved here and to lower greatly Chase's margin of profit);

6. Although the pension plans for hourly employees were separate, Kennecott administers a common retirement plan for salaried employees;

7. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters;

8. Salaries above $15,000 for employees of Chase and Kennecott Wire were submitted to Kennecott's salary committee for review;

9. Chase warehoused and sold some of Kennecott Wire's production of wire mill products; and

10. Chase annually purchased about 20% of Kennecott's copper output, all of the purchases of which were at prevailing market prices.

The Court of Appeal concluded (App. 21):

> "The fact of the sales alone, however, whether especially advantageous to Kennecott or Chase, does not determine the business to be unitary. The factors described under headings above, and particularly those relating to control of major policy, together with the subject of sales, bring us to the conclusion that the business among Kennecott, Kennecott Sales and Chase is unitary."

The Court of Appeal held that Chase was not unitary with either Braden or Bear Creek, but was unitary with Kennecott, Kennecott Sales and Kennecott Wire. It re-

manded the case to the trial court to try additional issues not decided and to calculate the limited refund due under its decision. (App. 22.) An appeal was taken to this Court, which was "dismissed for want of jurisdiction." (400 U.S. 961.)

After two trials, judgment for a partial refund was rendered (App. 28-29), from which both parties appealed. The Court of Appeals affirmed the judgment in all respects (App. 54), interpreting the statute as mandating the use of the three factor formula (App. 43-44). Both parties petitioned the California Supreme Court for a hearing which was denied on August 11, 1977 (App. 30). There is no further recourse open to appellant in the California courts, and no remand or other state proceedings are ordered or pending.

The judgment affirmed below consolidated the net incomes and allocation formula factors of Chase, Kennecott, Kennecott Sales and Kennecott Wire. It multiplied Chase's California 1954 net income 3.70 times, its California 1956 net income 11.20 times, and its California 1955 net income by infinity because without consolidation with Kennecott's net income Chase's own corporate net income was a net loss of $1,380,516.25, of which California's share was $29,826.05. The consolidation transformed Chase's corporate net loss of $1,380,516.25 due to a flood into a California-only net income of $1,068,250.61. These distortions were brushed aside on the ground that "rough approximation" is sufficient. (App. 48, 53-54)

The Notice of Appeal to this Court was filed with the Court of Appeal on September 12, 1977. (App. 55-57.)

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

1. a. The basic doctrines involved have been developed by this Court from the United States Constitution. The first

one is that a state cannot tax property located in another state, under the Due Process Clause (Amend. XIV; *Frick v. Pennsylvania,* 268 U.S. 473 (1925); *Looney v. Crane Co.,* 245 U.S. 178 (1917); *Delaware, L. & W. R. Co. v. Penna.,* 198 U.S. 341 (1905)). Property which moves regularly from state to state with substantial presence in each state may be taxed by those states on an apportioned basis, consistently with due process. *Pullman's Palace Car Co. v. Penna.,* 141 U.S. 18 (1891); *Union Refrigerator Transit Co. v. Lynch,* 177 U.S. 149 (1900). Due process permits the taxation of the entire value of personal property at the home port or base if its presence in other states is transitory. *Northwest Airlines v. Minnesota,* 322 U.S. 292 (1944). Thus due process has never been construed in a manner to permit California, where Kennecott has no property and does no business, to tax any of Kennecott's property, on an apportioned basis or any other basis. For purposes of due process, income is a species of property and the same analysis applies to income located, or earned, in another state. *Hans Rees' Sons v. N. Carolina,* 283 U.S. 123, 134-136 (1931).

b. A second basic doctrine developed by this Court is that the Commerce Clause limits a state's power to tax in order to prevent repetitive or duplicating taxes occurring solely because interstate commerce is conducted. (Art. I, Sec. 8, Cl. 3; *J.D. Adams Mfg. Co. v. Storen,* 304 U.S. 307 (1938); *Freeman v. Hewitt,* 329 U.S. 249 (1946); cf. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, note 15 (1977). It is obvious that the Commerce Clause could also be relied on to invalidate a California tax on the property Kennecott owns and employs in commerce exclusively conducted in other states, or on income derived from it, since

they have jurisdiction to tax it and a California levy would necessarily be a duplicating levy.

c. The rule permitting apportionment of multistate values between the states where the properties are found was extended from tangible property (*Pullman's Palace Car Co. v. Penna.*, 141 U.S. 18, supra) to intangible property values (*Adams Express Co. v. Ohio*, 165 U.S. 194 (1897)), then to taxes on or measured by net income (*Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Butler Brothers v. McColgan*, 315 U.S. 501 (1942)). However, this court has enforced the limitation that the formula apportionment may not be used to tax income or property the taxpayer can show is not derived from or employed in the taxing state. *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931); *Norfolk & Western R. Co. v. Missouri*, 390 U.S. 317 (1968).

d. The foregoing outline of the background law applicable here demonstrates that the legal area is one of limitations derived by this Court from the Due Process Clause and the Commerce Clause. It is thus exclusively an area of federal questions.

e. Never has this Court permitted the income, property or franchise of a nonresident corporation neither doing business in nor owning property in a particular state to be taxed by it. Here California is doing that very thing.

f. California's claim of right is that the nonresident corporations are "unitary" with a subsidiary which sells its own products in interstate commerce in California. Where this Court has sustained unitary apportionment between the states it has done so to obtain geographical division of the net income or property of a single, integrated enterprise. It has recognized that ordinarily a single, integrated enterprise operating in a uniform economic climate

will earn its net income from its entire geographic area of operation in a manner which makes probable the belief that it earns the same percentage of its net income in each state, in relation to property, payroll and sales in each state, and under this assumption, such a means of geographically dividing total income is inherently superior to a method which seeks to determine separately the income in each geographical unit (separate accounting). Since geographical division of the net income of an integrated business has no business significance and is relevant only to determine the measure of state taxes, the taxpayer's own computation of geographical source is tax inspired and is not controlling. The foregoing statements are the teaching of *Butler Brothers v. McColgan*, 315 U.S. 501 (1942). Where either of the assumptions of integrated use and operation, and uniform economic milieu, do not apply, the doctrine of *Butler Brothers* cannot apply.

The decision below takes three huge steps out from the foregoing established doctrine. First, it refuses to distinguish between formulary apportionment making geographical allocation of the net income of a single integrated business, on the one hand, and formulary apportionment which transfers income from one integrated and separately incorporated business to another integrated and separately incorporated business, on the other hand. The result here is to apportion income to the only business California can tax, out of all proportion to its actual earning power, and hence to apportion to California income actually earned by the non-taxable business conducted elsewhere. Second, it claims that formula apportionment of net income cannot be impeached by factual evidence of any kind, on the grounds that "rough approximation" is good enough and all formulas present "inherent inaccuracy". Third, it dis-

regards a finding of fact that the economic integration of two geographically separate businesses into one, which is necessary for applying the unitary concept, was absent, and reverses it into an irrebuttable conclusion of law that economic integration is assumed to be present where there is common ownership and any, even minor, exercise of an owner's interest in his property.

While the appellate decision found "unity of use" and "unity of operation" in contravention to the finding of the trier of fact, these were conclusive legal conclusions it drew from the only "unity" which actually existed, that of ownership. Any analysis of the facts leads incontrovertibly to the conclusion that of the combined businesses, unity was far less significant then separateness, for determining income, in "use" and in "operation". All are departures from this Court's previous doctrine and each presents an independent substantial question.

In what follows we have attempted to hone our argument more finely, in order to present the questions with greater precision.

2. The question whether the Commerce and Due Process Clauses permit California to tax Chase, operating one integrated business, on or measured by a portion of the income of its parent, Kennecott, the operator of another integrated business, is a substantial question, however it be approached.[6]

a. Beginning with the first examples of its authorized application in the last century, the unit rule has been applied to permit apportionment of taxable values of businesses sufficiently homogeneous that a presumption could rationally

6. Article 9(4) of the United States-United Kingdom Income Tax Convention, now pending before the Senate, would prohibit this type of consolidated apportionment by a state where a United Kingdom parent is involved.

be made that the relationship between the factors in the formula and the taxable values would be the same throughout the system. *Norfolk & Western Railroad Co. v. North Carolina,* 297 U.S. 682 (1936). Railroads, telegraph systems, farm equipment manufacturers and automobile manufacturers were examples.

Here, though, two separate unitary businesses to each of which a formula could properly be applied, have been consolidated and a single formula applied to the product merely because of common ownership. Evidence made available to the state courts but ignored by them showed that Kennecott had a margin of gross profit to sales of 34.3% in 1954, of 50.2% in 1955, and of 51.8% in 1956. By contrast, Chase had gross profit margins of 14.5% in 1954, of 12.6% in 1955, and of 11.9% in 1956. Its competitors had comparable margins. Not even a pretense could be made that a formula based on the assumption that the same relationship between sales and net income, and payroll and net income, could rationally apportion such a combination of net income to source, and the California courts made none because they thought it not constitutionally required. The question whether that belief is correct arises under the Commerce Clause and the Due Process Clause and is substantial because it involves the continued vitality of decisions of this Court, one of which, (*Norfolk & Western R. Co. v. Missouri,* 390 U.S. 317 (1968)), is only 9 years old.[7]

Other evidence of arbitrary application was also ignored by the California court. Chase did not manufacture in California. All that Chase did in California was sell finished products here. The record [Exh. P, the Franchise Tax

7. In addition, an opinion rendered in 1977 observes that care must be taken that the extension of state authority it sanctioned not produce impermissible apportionments of net income. *Complete Auto Transit, Inc. v. Brady,* supra. 430 U.S. 274, n. 15.

auditor's computations] showed that Chase had national gross sales of $159,564,138 in 1954, of $199,430,936 in 1955, and of $201,302,912 in 1956. The determination below [App. 76] was that from these sales came apportionable national net income of $60,694,164 in 1954, $102,627,592 in 1955, and $117,032,788 in 1956, or a ratio of net income to those sales of 38%, 51%, and 58%, respectively. Such a margin of net profits is an impossibility; facts before the state courts showed that Chase's three competitors earned an average net profit to sales of 11.23% for those years. Chase could not be expected to do as well as its competitors, for it had a $10,797,968 loss from flood in 1955 which produced a net loss of $2,370,010 in its federal taxable income for the year.[8]

b. Chase and Kennecott are not a single corporation, though Chase's stock is owned by Kennecott. The Court of Appeal in Chase I said explicitly that Kennecott did not do business in California (10 Cal. App. 3rd 496 at 500; App. 13), and the parties had so stipulated. No contention was ever made that Chase was Kennecott's mere agent or should be disregarded as a corporate entity. Indeed, Chase's corporate entity was the subject of the tax. The decision of the California courts recognized Kennecott was a separate corporation, but relied on the ownership of Chase's stock by it.

While Kennecott sold approximately 25% of its total refined copper output to two of its subsidiaries, and Chase's share was 20%, the price and terms paid by Chase were the same as those Kennecott charged its other customers who bought the remaining 75% of its copper output. (App. 69.) The Court of Apeal in Chase I stated these facts were not in dispute. (App. 15). No facts were relied upon by the Court of Appeal to show that Kennecott shifted income

8. The state and federal definitions of net income were basically alike.

from Chase to itself in any other manner either. There was no shifting of deductions or expenses, and what the record did show, which the court seized upon as unitary, was some minor services performed by Kennecott for Chase without cost to the latter. The result was, to the extent these minor circumstances affected the income of either corporation, to increase the income of Chase because Chase received the benefit of the minor services without cost to it. Yet on their account California allocated a portion of Kennecott's income to Chase by consolidating the two and applying an apportionment formula to the consolidated total.

The record contains the sources from which can be determined the respective corporate net income of the two corporations.[9] The decision below, however, after consolidating Kennecott's property, payroll and sales with those of Chase and then apportioning by formula, shifted Kennecott's net income to Chase with the following consequences:

	Column 1 Chase California Net Income per State's Consolidated Formula	Column 2 California Sales (entirely Chase)	Column 3 Percentage of California Net Income to Sales
1954	$ 560,820	$ 6,506,832	.0935
1955	1,068,250	9,589,614	.1114
1956	1,292,229	10,422,917	.1240

The State's formula does not dispute that Chase's national sales are as reported in Chase's tax returns, and the State used the figures in Column 2 in its formula. Neither does

9. The federal income tax returns of both corporations, with the federal audit adjustments, are in the stipulated record. The California Franchise Tax Board adopted the federal adjustments, and that produced the corporate net incomes it consolidated. (App. 52.)

it dispute that Chase's national gross profit (sales less cost of goods sold) is as stated in its federal and state tax returns. Those returns show that Chase's actual national margin of *gross* profit was:

	Column 1 Total National Sales, per State Auditor	Column 2 National Gross Profit	Column 3 Percentage of Gross Profit to Sales
1954	$159,564,138	$23,137,690	.1450
1955	199,430,936	25,308,602	.1269
1956	201,302,912	23,969,534	.1190

Thus the record shows that the percentages of both Columns 3 are nearly equal for 1955 and that the *net* income apportioned to California in 1956 actually exceeds the margin of *gross* profit. California accomplishes this legerdemain by allocating some of Kennecott's income to Chase. Although admitting that Kennecott did not charge Chase too much for its copper, California has attributed more California *net* income to Chase than Chase's California *gross* income.

This must be an arbitrary result, impossible of attainment by any business. General and overhead expenses, depreciation, interest and property taxes must be paid and they are deductions in computing net income, not gross profit. But California's method attributes as much net income to Chase *after* paying its expenses as its gross profit was before paying them.

This arbitrary result is the consequence of consolidating Kennecott's highly margined net income with Chase's lower margined net income. California has, as Missouri was reproved for doing in *Norfolk & Western—Missouri,* supra, stood mute,* relying on the presumption of correctness and

*The Court of Appeal evidently felt this was a lack, for it embellished its opinions with assumptions and suppositions having no foundation in the record. (App. I, App. 77 et seq.)

the "rough approximation" test, instead of offering explanations for the transformation. It has pointed to minor consequences of common ownership, but there was single ownership in *Norfolk & Western—Missouri* and Missouri lost because it failed to demonstrate how that enhanced the number of cars it sought to tax. California has also failed even to attempt such a demonstration.

The United States Treasury Department has issued regulations which refuse to accept the consolidated apportionment as an accurate reflection of domestic income, where states have imposed taxes on the product of consolidating foreign and domestic operations. Treas. Reg. Sec. 1.861-8(g), Examples (25) and (26). These regulations therefore classify some of the state income taxes as foreign related items, even though the state tax professes to tax only local income as determined by the consolidated apportionment method we are attacking here. The Treasury's regulation adds support to our contention that the question is substantial.

The applicability and continued vitality of prior decisions of this court[10] holding unconstitutional arbitrary assignments of taxable values to the taxing state present a substantial question.

c. Another approach involves the fact that California deliberately structured its tax to be a franchise tax measured by net income, and not a tax on net income. In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), this Court obliterated one of the cardinal distinctions between a franchise tax measured by net income and a tax on that net income. However, for the California tax the distinction

10. In addition to *Norfolk & Western—Missouri* there is *Hans Rees' Sons v. North Carolina,* 283 U.S. 123 (1931); and in *Butler Brothers v. McColgan,* 315 U.S. 501, 507-508 (1942), this Court has implied that proof of disparate conditions in the taxing state would overturn an apportionment formula.

must still remain, because California measures its franchise tax by tax exempt income. *Pacific Co. v. Johnson,* 285 U.S. 480 (1932), sustained the right of California to tax in that manner and that right was critical to its taxation of national banks, since their tax is measured by tax exempt income as well as other income, and other corporations must be taxed in the same way they are. R.S. Sec. 5219, 12 U.S.C. Sec. 548, prior to 1969 amendment. Treating the tax, accordingly, as one which should be measured by something germane to the value of what is being taxed, there is a substantial federal question whether the franchise of Chase is made more valuable because its stock is owned by another corporation instead of a group of individuals. For what is being used as the measure of the tax on Chase's franchise is a portion of the income of its corporate parent. It could be argued that the value of the franchise of the corporate parent includes the value of its stock in Chase, but an argument in reverse, which must be made here, is unreal. California grants no franchise to Kennecott, confers no rights or benefits on Kennecott, and should be permitted to tax Chase, on whom it does confer benefits, only on Chase's net income derived from California operations and not on any of its parent's net income, derived from the parent's Utah, Nevada, Arizona, New Mexico, and New York operations.

d. A closely related substantial question is whether California burdens interstate commerce and offends due process by so employing its consolidation and apportionment technique as to convert Chase's loss in 1955 from the disastrous effects of a flood at one of its plants into a profit. The case is not like *Butler Brothers v. McColgan,* 315 U.S. 501 (1942), and *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission,* 266 U.S. 271 (1924), where losses made to appear by separate accounting but having no demonstrated cause were held unavailing to overturn the presumptive correctness of the

formula. Here the loss is explained; a nine-month shut-down of Chase's major plant could hardly produce any result but a loss, but California has allocated enough of Kennecott's net income to Chase in 1955 not only to eliminate the loss entirely but to assign Chase a larger profit in 1955 that it had from its unimpaired operations in the previous year.[11]

The assignment of this fictional profit is arbitrary, taxes the income of Kennecott, which is beyond California's taxing jurisdiction, and presents substantial questions under the Commerce Clause and the Due Process Clause.

3. A substantial question is presented whether, in view of its more recent decision in *Norfolk & Western R. Co. v. Missouri Tax Commission,* 390 U.S. 317 (1968), this Court intended its statement in *International Harvester Co. v. Evatt,* 329 U.S. 416, 422, (1947), that "rough approximation rather than precision is sufficient" to mean that any formulary apportionment of net income is immune to constitutional attack. The California courts have repeatedly quoted that statement, but they have not quoted the remainder of the statement. This Court went on to say (329 U.S. 422-423): "Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this court has not been willing to nullify honest state efforts to make appor-

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11. The California courts justified this result by citing language in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal. 2d. 214, 228, 238 P. 2d 569-70, which appears to say that the geographical source of the net income is irrelevant. If the court meant that, it misread decisions such as *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 133 (1920), *supra,* holding that the source of sales revenue is not the sole source of *net* income. The refusal by this Court to take the case on the merits (343 U.S. 939) has been interpreted by the California courts here as an affirmance by this Court, and has contributed greatly to the California conception that there are no constitutional limitations in this area of law.

tionments." The first part of the quotation was quoted by the Court of Appeal in Chase II, as it had previously been quoted in a case relied upon, *Household Finance Corp. v. Franchise Tax Board,* 230 Cal. App. 2d 926, 930, 41 Cal. Rptr. 565, but the second part has been ignored.[12]

In the latter case (*Household Finance*) the court used the quotation to justify disregarding the effect on the payroll factor of the higher wage rates paid employees in California than in other states, the taxpayer contending that to use those unequal wage rates without equalization necessarily distorted by apportioning more net income to the state with the highest cost of operation. In the instant case, reference to the quotation was made to answer the argument that the *net* income attributed to Chase by its combination with Kennecott approximated the *gross* income from its California sales and could not possibly have been representative of any net income Chase or any competitor could conceivably have earned from California operations. No effort was made to answer the taxpayer's contention that the income allocated to California could not possibly have been earned from the California sales, about the amount of which there was no dispute, other than the remark that "rough approximation" is sufficient. Not only did this Court use the remainder of the language quoted above from *International Harvester,* which clearly recognized that there could be cases in which the unfairness of the apportionment went beyond mere "rough approximation", but as we pointed out to the California courts, in a more recent decision this Court had restated the requirement that there be some

12. Shepard's United States Citations reveals that between 1947 and 1976 the California courts cited *International Harvester* in eleven (11) different cases, and the courts of 23 other states cited it 39 times. Examination of the opinions reveals that unfailingly it was cited for the "rough approximation" language.

fair relationship between the opportioned values and actuality. This more recent decision is *Norfolk & Western R. Co. v. Missouri Tax Commission, Supra,* 390 U.S. 317 (1968). The California court did not respond to our citation of *Norfolk & Western—Missouri* until the denial of the petition for rehearing in Chase I, where it said of that case that the taxpayer in it had been able to make an "actual count of its rolling stock", and furthermore the case differed from the instant case "wherein the operations of the corporations are unitary and separate accounting is not permitted." 10 Cal. App. 3d 505, 95 Cal. Rptr. 811.

The reasons given on the denial of the petition for rehearing in Chase I for refusing to recognize the force of *Norfolk & Western—Missouri* will not withstand analysis. The Norfolk & Western Railway was a classic example of a unitary business, being a railroad operating between several states, and it has been so held by this Court in *Norfolk & Western Railway Co. v. North Carolina,* 297 U.S. 682 (1936). Hence it was not different from Chase but just like it, in that respect. In the second place, the evidence offered in the Missouri case was also separate accounting, if by separate accounting the Court of Appeal meant proof of the actual taxable value. That this Court meant its decision to apply to the statute involved herein is evident, because it cited *Butler Brothers v. McColgan,* 315 U.S. 501 (1942), which involved the very California franchise tax law involved in this case, and also cited *Norfolk & Western Railway v. North Carolina,* supra, involving a state income tax. See 390 U.S. at 326.

In Chase II the Court of Appeal made its view that the results of apportionment formulae are beyond constitutional attack even more clear. Faced with final apportionment figures made on remand, showing the conversion of an over-

all loss from operations attributable to a flood to a California net income of over a million dollars, and figures which in other years attributed to California a net income from sales, after the payment of all operating expenses, equal to the gross income from the same sales, the court defended that result by saying that "there is an inherent inaccuracy in any use of the unitary business allocation formulas" (App. 54). The court was thus saying that evidence that the formula reached an improbable result was beside the point, for formulas contain "inherent inaccuracy". It did essentially what this Court condemned in *Hans Rees' Sons v. N. Carolina,* 283 U.S. 123 (1931), and in the more recent (1968) *Norfolk & Western—Missouri* case.

Only this Court can tell the state courts what it meant by the language it used in *International Harvester v. Evatt,* and whether its decision in *Norfolk & Western—Missouri* was intended to be confined to property tax cases, notwithstanding the citation of income tax cases in stating the standard of evidence the taxpayer had to produce to succeed. Only this Court can determine whether its language in *International Harvester* has indeed removed the question of the right to tax extraterritorial income by an apportionment formula from the realm of constitutional law.[13]

It is impossible to make a physical count of net income, although that is possible for property. That should not make *Norfolk & Western—Missouri* inapplicable to apportionment of net income. Hellerstein, *Recent Developments in State Tax Apportionment etc.,* 11 National Tax Journal

13. The state courts may be misled by language. Mr. Justice Black dissented in *Norfolk & Western—Missouri,* but it was he who wrote that opinion for the court in *International Harvester,* supra. His dissent in *Norfolk & Western—Missouri,* cited his opinion for the Court in *International Harvester* as the reason for his dissent (390 U.S. 330, 332).

487 (1968). We believe no stronger factual demonstration of distortion in net income apportionment will ever be made than that presented to and dismissed by the Court of Appeal.

4. The inevitable tendency of the decision below to cause double taxation and thus burden interstate commerce is a substantial question. The essence of interstate commerce is the shipment and sale of goods beyond the borders of the state of production. Kennecott mines and refines its copper in Utah,[14] and sells and ships it to customers in other states. One of these is Chase, to whose plants in Connecticut and Ohio Kennecott ships and sells copper; Kennecott ships no copper to Chase in California. Chase in turn converts the copper into brass and shapes it (App. 62) and ships its product to warehouses from which it sells to its customers. One of its warehouses is in California (App. 14) and because of it California asserts the right to allocate some of Kennecott's net income to Chase and tax Chase on it.

Obviously if California can do this so also can every state in which Chase has a presence. Chase's shipments in interstate commerce will indeed be expensive for Kennecott if Utah, Arizona and New Mexico assert the right to tax Kennecott for mining ore in their states without eliminating from their tax base what California and other states have taxed to Chase.

Utah has done this. It is a state with primary jurisdiction to tax Kennecott. In Utah Kennecott has its greatest mine, two concentrators, a smelter (since 1959), and two refineries. Utah's jurisdiction to tax its operations there is not in doubt. Utah has adopted the Uniform Act for apportioning income, which closely resembles the California statute

14. It also mines in Arizona, Nevada and New Mexico but has no refining capacity in those states, the refining of such concentrates being done in Maryland by American Smelting (ASARCO).

involved here.[15] It interpreted the Uniform Act to permit it to tax Kennecott on a divisional net income; i.e., that of the Utah Copper Division, without reduction for the expenses of the headquarters operation in New York, and without reduction for any income California might assign to itself and tax through Chase. *Kennecott Copper Corp. v. State Tax Commission of Utah,* 27 Utah 2d 119, 493 P. 2d 632 (1972), app. dism. 409 U.S. 973. Although the Utah Supreme Court did not mention the prior California decision in Chase I, that court must have been aware of it, for it was cited in Finding 29 of the Utah Tax Commission in respect of the assessment the state court upheld.

The Attorney General of California recognized the impropriety of burdening interstate commerce with multiple taxation through the medium of tailoring tax systems[16] and joined Kennecott in asking this Court to review the Utah decision. Its brief amicus curiae stated that harmonization of such conflicting methods of apportioning net income among the states for taxation was a substantial federal question warranting this Court's intervention.[17]

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15. California too has adopted it for subsequent years. The California tax authorities interpret it as approving their practices, not changing them.

16. As this Court did quite recently in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), where in footnote 15 it spoke of the "increased danger of error in apportionment, [and] of discrimination against interstate commerce" through "tailored tax(es) . . . (which) must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce."

17. Brief of the State of California as Amicus Curiae, No. 72-319, October Term 1972, pp. 3, 5, 10. The Brief stated that any single case presented merely "the tip of the iceberg" (p. 3), that the use of diverse apportionment methods by California and Utah "would appear to present a serious federal question" (p. 5), and the case presented "an important federal question which affects a majority of the states and thousands of large corporate tax payers" (p. 10).

The need for harmonization remains. The tenuous nature of California's claim to reach income which the states where Kennecott does business have the unquestioned right to apportion among themselves makes the question the Attorney General of California agreed was substantial in the Utah case even more substantial here.

There is no court but this one with jurisdiction to harmonize the competing claims of the states, and with jurisdiction to reverse the state high courts which go too far. Through adoption of the Johnson Act (28 U.S.C. Sec. 1241), Congress has prevented the lower federal courts' lending a hand. See *Tully v. Griffin,* 429 U.S. 68 (1977). The result is that either this Court must police this area or turn its back on it and let the Constitution lie dormant in it.[18] The need for harmonization is shown not only here but by the recent decision of the Iowa Supreme Court in *Moorman Mfg. Co. v. Bair,* ..... Iowa ....., (appealed to this Court) 254 N.W. 2d 737, upholding an apportionment by the single factor of sales, apparently contrary to *General Motors Corp. v. District of Columbia,* 380 U.S. 553 (1965).

In the Utah case the Court can see how one state has dealt with the ideal of uniformity which led it and 30 others to adopt the Uniform Act.[19] Many states with the same Act

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18. See Stolz, *Federal Review of State Court Decisions of Federal Questions etc.,* 64 Calif. L. Rev. 943, where the author argued for the creation of a National Court of Appeals because "Federal questions in state courts are being finally resolved by state courts" (at p. 959) whose judges feel little bond to this Court and a greater one to "local political forces" (at p. 960).

19. See comment on the Utah case and inability of the Multistate Tax Commission to enforce uniformity on the states in Schoettle, *The U.K. Treaty and the State Taxation of Corporate Income,* V Tax Notes 3, 7 (Apr. 4, 1977) a Special Report published by Tax Analysts and Advocates. Prof. Schoettle remarks that "The case undoubtedly lends credence to business' allegation that expediency, not uniformity, is the guiding principle of statutory interpretation for some MTC member states."

are double-weighting the sales factor in order to get a larger share of the unitary income.[20] And California treats all corporations with common ownership as part of a single unitary tax group however different the businesses of the components may be, and however disparate the relationship between net income and property, payroll and sales within the group.

The Court should start someplace. Hellerstein, *Recent Developments in State Tax Apportionment etc.* 11 National Tax Journal 487 (1968). The questions in this case are federal and are as substantial and as unresolved as when the California Attorney General urged this Court to review the Utah case.

5. Substantial questions of discrimination in taxing interstate commerce are present, involving the Commerce Clause and the Due Process Clause. The first one is whether a state can tax a corporation more heavily because its stock is owned by a single corporate shareholder instead of two or more shareholders in the absence of abuse of power by the shareholder to shift income from the subsidiary to itself.

Of course a state does not discriminate by taking measures to avoid being cheated by income shifting. But there is no claim that that has occurred here, or been attempted. The record shows it did not happen (App. 6, 7, 21). The tax imposed is imposed solely because Chase's stock is owned by a single corporation and not equally by two corporations, or by many individuals.

A corporation is entitled to the protection of the Equal Protection Clause. *AirWay Appliance Corp. v. Day,* 266 U.S. 71 (1924); *Wheeling Steel Corp. v. Glander,* 337 U.S.

20. See Prof. Jerome Hellerstein's criticism of this trend, in *State Tax Discrimination against Out-of-Staters,* 30 National Tax Journal 113, 123 (June, 1977).

561, 574-576 (1949) and cases cited; *Allied Stores of Ohio v. Bowers,* 358 U.S. 522, 530 et seq. (1959). Presumably the protection against discrimination afforded by the Due Process and Commerce Clauses is equally broad.

The Due Process Clause also protects against discrimination. *Meyer v. Nebraska,* 262 U.S. 390 (1923); *Washington v. Roberg,* 278 U.S. 116 (1928); *Korematsu v. United States,* 323 U.S. 214, 234 (1944); *United States v. Petrillo,* 332 U.S. 1 (1947); *Hurd v. Hodge,* 334 U.S. 24 (1948); *Bolling v. Sharpe,* 347 U.S. 497 (1954); *Sims v. Rives,* 84 F.2d 87 (1936), cert. den. 298 U.S. 682.

Finally, discriminatory taxation adversely affecting interstate commerce violates the Commerce Clause. *Welton v. Missouri,* 91 U.S. 275 (1876); *Nippert v. Richmond,* 327 U.S. 416 (1946); *Boston Stock Exchange et al v. State Tax Commission,* 429 U.S. 318 (1977).

a. In a case decided after Chase I, the California courts held that commonly owned corporations operating exclusively within California could not be consolidated or file combined reports. *Handlery v. Franchise Tax Board,* 26 Cal. App. 3d 970, 103 Cal. Rptr. 465 (1972), app. dis. 410 U.S. 921. The court construed the section applied here as applicable only to corporations doing business both within and without the state.

Section 25105 of the Law (App. 59) defines the "control" required for consolidated apportionment as ownership of "more than 50 percent of the voting stock."

Thus this case involves a state statute which either permits (its language) or mandates (its judicial interpretation) consolidated apportionment only where interstate business is done, and only if some corporation owns more than 50% of the stock of the other corporation. No burden

of proving manipulation for tax inspired purposes, or preferential pricing, or abuse of control, is placed on the state, and indeed it need not prove anything at all.[21] These are the only two conditions the state requires for consolidated apportionment, and the question is whether they are discriminatory and in conflict with these federal constitutional provisions.

If the statutory purpose were to prevent abuse of control to shift income out-of-state where it could escape tax, distinction between controlled corporations operating wholly in-state and those operating multi-state would be rational, but the statute is not dependent on such facts but instead has been held to function automatically. Again if manipulation were the concern, control exceeding 50% could be a rational point at which to begin investigation, but California has made 100% consolidation mandatory between a corporation and its 50 + % subsidiary, without regard to distorting consequences.

The question is presented whether it is reasonable to allocate some of another's income to a corporation doing interstate commerce into California merely because its stock is owned by the former corporation instead of by two corporations, or 500 individuals, or a mixture of both. Chase is taxed by California more heavily than its competitor Revere Copper because the latter has none of American Smelting's income visited upon it, although American Smelting owned 35% of Revere's stock, the rest being widely held, whereas Chase must pay a tax measured by some of Kennecott's income.

It is convenient for California to presume conclusively that Chase is manipulated by Kennecott and tax it more

21. No state judicial review is available until after payment of the disputed tax, in a suit for refund where the burden of proof is on the taxpayer.

heavily than its competitor, but is it constitutional? Should not Chase and its competitor be permitted by California to conduct their interstate commerce on equal terms?

This discrimination presents substantial questions under the Due Process Clause, and the Commerce Clause.

b. A substantial question of forbidden discrimination also arises from the fact that California has virtually converted the measure of its tax in appellant's case from net income to gross profit. It does not so tax other corporations. California can measure its franchise tax by gross profit instead of net income if it wants to. But if it does so it must use that tax base for all corporations and not merely for appellant. It must use it without discrimination, and certainly may not use it to discriminate against those corporations engaged in interstate commerce in California.

A business will normally have a margin of gross profit between two and three times the size of its margin of net income. This means the same tax rate imposed on a gross profit will produce a tax two to three times greater than when imposed on net income. The effect of the discrimination is thus substantial.

6. More than merely illustrative of the difficulties state courts face when they try to compromise with the principle that a state cannot tax income earned outside its borders, and representing independent substantial federal questions, are two distorting aspects of the formula as finally used below.

a. The formula used by California is the three factor formula of property, payroll and sales, each factor weighted equally. At the first trial, the Board valued Kennecott's mines, all of which were out-of-state, at federal income tax basis, which would have been zero but for a mathematical error made by the Board's auditor. An expert witness, using

Hoskold's formula, valued them at more than $500,000,000 and the trial court so found. (App. 2.) On appeal the Attorney General confessed error but the Court of Appeal remanded instead of using the figures before it. On remand original cost of some $150,000,000 was substituted and this was affirmed below. (App. 26.) The original cost included 1910 land costs, before the huge size of the Utah ore body was known, whereas the original cost of the inventory and equipment comprising Chase's California property was 1954 cost. (App. 46.) The state thus used current value for the California property and a figure one-third the current value for the out-of-state mines, increasing the California property percentage and thereby increasing the formula's tendency to apportion income to California.

b. In Chase I, the Court of Appeal held that Kennecott's net income from sales of gold, silver and molybdenite was not part of the business it found was unitary with Chase, which it held was the copper business. In the remand proceedings, both property and payroll were removed from the out-of-state figures in the proportion that gold, silver and molybdenite sales bore to total sales. However, evidence in the record shows that some of the facilities and payroll thus removed were used for copper production and not for molybdenite production. Molybdenite is produced at the milling (concentrator) stage, and the succeeding processes of smelting and refining have no role in its production. Yet smelter and refinery property and payroll were excluded from the out-of-state factors in the proportion that molybdenite sales bore to total sales. (App. 51-53.) In addition, the Arizona mine and mill produce no molybdenite, yet the same proportion of the property and payroll there was excluded. Finally, the New Mexico mills, smelter and refinery are incapable of producing any gold or silver,

yet the proportion of their value and payroll corresponding to the ratio between gold and silver sales and total sales was excluded from the out-of-state property and payroll factors.

Our objections to these palpable errors were brushed aside on the ground that "there is an inherent inaccuracy in any use of the unitary formulas". (App. 54). A substantial question is presented whether palpable error can be ignored as inevitable in the use of formulas, in view of *Norfolk & Western—Missouri,* 390 U.S. 317, where demonstrated taxation of extra-territorial values was held to be, not permissible "rough approximation", but a "distorted result so excessive as to burden interstate commerce." (390 U.S. at 329)

CONCLUSION

The issues arise under the Commerce and Due Process Clauses as interpreted in prior decisions of this Court, so they are federal questions. They are important to the free flow of interstate commerce, are of recurrent character, important to the 31 states using net income as a tax measure or subject, and are of magnitude in amount. The decision below is probably wrong under this Court's most recent decision in this area of law, and is an example of what this Court said at its last term are two of the problems with which the Commerce Clause is concerned: An error in apportionment, and discrimination in taxation of interstate commerce. The questions are substantial and deserve plenary consideration.

Probable jurisdiction should be noted.

Respectfully submitted,

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(Appendices follow)

Appendix A

Filed Mar-1968

Superior Court of the State of California
For the City and County of San Francisco

No. 538595

Chase Brass & Copper Co., Incorporated,
Plaintiff,

vs.

Franchise Tax Board of the State of California,
Defendant.

FINDING OF FACTS AND CONCLUSIONS OF LAW

The above-named case came on regularly for trial on November 14, 1966. Plaintiff was represented by Kent, Brookes and Anderson, appearing through Valentine Brookes. Defendant was represented by Thomas C. Lynch, Attorney General of the State of California, appearing through Ernest P. Goodman, Assistant Attorney General, and John J. Klee, Jr., Deputy Attorney General. Having considered all the evidence and the briefs submitted by the parties, the Court now makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The facts stated in the Stipulation of Facts on file herein are true and the Court hereby adopts said Stipulation as findings of this Court.

2. The testimony of the witnesses offered by plaintiff is uncontradicted and the Court finds that the facts stated

by said witnesses are true. In that regard, the Court specifically finds that:

(a) The fair market value of Kennecott's mining properties (including the equipment and reduction facilities at the mine sites) was as follows on the dates indicated:

Date	Fair Market Value
January 1, 1954	$585,346,677
January 1, 1955	577,317,053
January 1, 1956	568,978,394
January 1, 1957	560,180,039

The Fair market value of Braden's mining properties (including equipment and reduction facilities at the mine sites) was as follows on the dates indicated:

Date	Fair Market Value
January 1, 1954	$141,806,405
January 1, 1955	141,475,283
January 1, 1956	141,133,657
January 1, 1957	140,779,691

The value of the equipment and reduction facilities at the mine sites, if owned by someone who could not use them in conjunction with the mines, would be mere salvage value.

(b) On February 12, 1952, the Republic of Chile required Braden thereafter to sell all copper it mined in Chile to the Chilean Government under Law No. 10255. The Chilean government set the price at which it would buy the copper, and then resold it at a profit to itself of about eleven cents a pound. While Law No. 10255 was in effect, Braden sold its copper to the Chilean Central Bank for the price set by the Chilean Government at 24½ cents per pound. This price was the same as the one in effect for sales of domestically produced copper in the United States under federal copper price-control regulations promulgated during the Korean

War. But World copper prices prevailing outside the United States averaged about 35½ cents per pound, and this was the price which the Chilean Central Bank obtained for its sales of Braden copper on the world market, and for its exports of copper to the United States. Since Chilean Central Bank personnel lacked experience in the international copper market, the Bank appointed Kennecott Sales the selling agent for all Braden copper so sold. This law was in effect until May 31, 1955, when it was repealed by Law No. 11828.

(c) The Chilean Government's Copper Department effectively set minimum prices at which exports could be sold after March 28, 1956. This was done by the Copper Department's pressure on the major Chilean copper producers, Braden and Anaconda, to enter into unpublicized agreements to sell all Chilean copper at the highest price prevailing on any of the major metal markets. As a result, Braden copper was sold in the United States domestic market at the London Metal Exchange price. The purpose of the Chilean action was to maximize its tax revenues from the copper producers.

(d) The Copper Department of the Chilean Government issues an export license for every ton of copper exported from Chile. In this manner, the Chilean Government assures a supply of domestically mined copper for the Chilean industrial users of copper. Braden, therefore must supply local Chilean industry with any amount of copper that they ask for. In some years, Braden has delivered substantial quantities of copper to Chilean industry, while in other years, it has delivered relatively little; in the years here involved, it delivered to Chilean industry from 4% to 16% of its annual production.

(e) Because it is fire-refined copper and not electrolytically refined copper, Braden copper was not well suited to

sale on the United States market except for use in brass and bronze. It was customarily sold in the world market and not in the United States. Kennecott copper being electrolytically refined was sold in the United States market. When United States demand exceeded domestic supply (such as in early 1956), Braden Copper was imported into the United States. If it was to be used for conductive purposes it required re-refining, so it was largely sold for alloying into brass and bronze.

(f) The price of copper in the European market generally fluctuates more than does the domestic "producers' price." In the early part of 1956 when copper was in great demand, the European price was 87 cents per pound, whereas the domestic "producers' price" remained at 36 cents per pound.

(g) Neither Kennecott nor Braden has ever had an internal sales organization to sell its copper production. Prior to 1934, each sold its copper through an independent agency which received $1.00 per net ton commission. In 1934 Kennecott Sales was formed and took over the function of selling agent for Kennecott and Braden. Kennecott Sales was compensated therefor on the same commission basis that the independent agency had been. During the years 1954, 1955 and 1956, Kennecott Sales received $1.00 per net ton commission for sales of Kennecott's copper.

When Chilean law required Braden to sell its copper to the Central Bank of Chile, Kennecott Sales was appointed the Central Banks' selling agent for export sales of this copper, and was paid ½% of the net sale proceeds as commission. From May 1955 through March 1956, Kennecott Sales received $1.00 per net ton commission on sales of Braden copper. After March 1956 the commission was $1.25 per net ton. No tax authority of the United States or Chile

has ever questioned the reasonableness of the commissions paid to Kennecott Sales.

(h) In the years in question, Braden had net profit on molybdenite and Kennecott had net profit on metals other than copper, principally gold, silver and molybdenite, in the following amounts:

	1954	1955	1956
Braden	$ 1,786,328.29	$ 2,633,771.88	$ 2,611,516.06
Kennecott	30,321,857.61	32,743,300.57	34,835,182.66
Total	$32,108,185.90	$35,377,072.45	$37,446,698.72

For the purposes of this finding, "net profit" means gross sales price less direct expenses incurred after the particular metal has been separated from the copper. "Net profit" does not take into consideration any indirect expenses, such as overhead, or any direct expenses incurred in the mining, concentrating or smelting of the ore prior to the time the copper bearing material is separated from the material containing these other metals; for internal accounting purposes, Kennecott treats all such direct expenses and indirect expenses as costs of producing copper.

(i) During the years 1954, 1955 and 1956 Kennecott operated oil properties jointly with Continental Oil Company. The Franchise Tax Board did not include that joint venture within the group of corporations which it determined constituted a unitary business. During these years, the books and records of the joint venture showed a loss.

(j) Kennecott Sales sells the copper produced by Kennecott and Braden to a relatively few customers. None of these customers other than Chase or Kennecott Wire are related by stock ownership to Kennecott. It is customary for Kennecott Sales to supply from 25 to 70 percent of the copper requirements of any large fabricator to which it

regularly supplies copper. During the years 1954, 1955 and 1956, Kennecott supplied to two independent fabricators, Revere Copper & Brass and General Cable, a combined annual average of about 87,000 tons of copper. About one-third of the stock of each of these companies was then owned by American Smelting and Refining Company, a major custom smelter and copper refiner. Nevertheless, Kennecott Sales supplied about 50% of Revere's copper requirements and about 60 percent of General Cable's.

(k) Anaconda, Phelps Dodge and Kennecott are the three big copper producers. Phelps Dodge's fabricating divisions consume all or nearly all of Phelps Dodge's copper production. Anaconda asks its customers not to ship the copper Anaconda produces to independent fabricators, but to use the Anaconda fabricating facilities instead. Because of this, it is doubtful that Chase and Kennecott Wire could buy substantial amounts of copper at the producer's price from any United States source other than Kennecott Sales. The producer's price is the price charged by the primary producers of unwrought copper; primary producers are the companies such as Kennecott, Anaconda and Phelps Dodge that are integrated from the mining through refining stages of copper production. The custom smelter's price is the price charged by companies such as American Smelting and Refining Company that smelt and refine reclaimed copper and copper mined by others. In the years 1954, 1955 and 1956 the producers' price was, on the average, lower than the custom smelter's price. The custom smelter's price fluctuates more often and over a greater range than does the producer's price.

(l) Neither Kennecott nor Kennecott Sales has ever used its market position to help Chase or Kennecott Wire acquire a customer, although the opportunity to do so has existed.

In times of copper shortages, Kennecott does not supply its subsidiaries copper more favorably than it supplies its other customers. Kennecott policy is one of not favoring Chase or Kennecott Wire in any way over any of its customers.

(m) The apportionment formula used by defendant operates to assign to Chase income earned by the income-earning activities of Kennecott, Braden and Kennecott Sales. Since the income-earning activities of all the corporations are separate and distinct and capable of ascertainment by reference to the operation of market forces, there is no need to resort to an artificial redetermination by formula of the incomes of each corporation.

(n) Chase's business activities are not so inter-related with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected on each's separate books of accounts. Chase's income and expenses all arise as a result of arm's length dealing at market prices. The contacts between Chase and the other corporations were of extremely minor significance in relation to the income-earning activity of each corporation. The only substantial business contact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent marketplace.

(o) Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership.

3. In computing the assessed tax, defendant included in the numerator of Chase's property factor property in transit to California destinations in the following average amounts:

1954	1955	1956
$180,414.00	$296,282.00	$322,496.00

By stipulation, plaintiff and defendant agreed not to litigate the propriety of this adjustment. The parties agreed that one-half of the above sums for each year would be included in the numerator of Chase's property factor.

CONCLUSIONS OF LAW

From the foregoing findings of fact, the Court reaches the following conclusions of law:

1. Chase was not engaged in a unitary business with Kennecott, Braden, Kennecott Wire, Kennecott Sales or Bear Creek, collectively, or with any one or more of them. Accordingly, it was improper for the Franchise Tax Board to compute the California income of Chase and Bear Creek by the combined report approach. It was also improper for the Franchise Tax Board to assess Bear Creek's asserted tax liability to Chase.

2. In view of the foregoing conclusion of law that Chase was not engaged in a unitary business with any other corporation, this Court deems it unnecessary to determine any of the following issues presented by plaintiff:

(a) Whether defendant's particular apportionment formula was a proper one for consolidating the group's property, payroll, sales and net income.

(b) Whether defendant's assessment violated the equal protection clause of the Fourteenth Amendment to the United States Constitution.

(c) Whether defendant's assessment violated the interstate commerce clause of the United States Constitution (Art.I, § 8, cl. 3).

(d) Whether defendant's assessment violated the foreign commerce clause of the United States Constitution (Art. I, § 8, cl. 3, and the exclusive interest of the national government that its relations with Chile embodied in treaties and informal agreements be free from interference by California.

(e) Whether defendant's assessment violated pre-emptive federal legislation establishing the taxable status of Western Hemisphere Trade Corporations (Int. Rev. Code of 1954 §§ 33, 901-905, 921-922).

3. The Franchise Tax Board did not act unreasonably or arbitrarily in excluding from the property factor Chase's investment in the construction in progress at its Waterbury, Connecticut plant.

4. Plaintiff is entitled to judgment in the sum of $231,257.32, together with interest thereon from July 12, 1963, as provided by law.

Let judgment be entered accordingly.

Dated: March 6, 1968.

/s/ EDWARD MOLKENBUHR

.....

Judge of the Superior Court

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Attorneys for Plaintiff

In the Superior Court of the State of California in and for the City and County of San Francisco

No. 538595

Chase Brass and Copper Co., Incorporated, Plaintiff,

vs.

Franchise Tax Board of the State of California, Defendant.

JUDGMENT

The Court having considered the evidence and the arguments and briefs of counsel, and having made its findings of fact and conclusions of law, it is in conformity therewith:

ORDERED, that judgment be entered for plaintiff in the amount of $231,257.32, together with interest thereon from July 12, 1963, as provided by law, and for costs in the amount of $25.20.

Dated: March 6, 1968.

/s/ Edward Molkenbuhr
Judge of the Superior Court

Appendix B

10 Cal.App.3d 496

Chase Brass and Copper Co., Incorporated,
Plaintiff and Respondent,

v.

Franchise Tax Board of the State of California,
Defendant and Appellant.

Civ. 25911.

Court of Appeal, First District,
Division 4.

April 29, 1970.
Rehearing Denied May 27, 1970.

Hearing Denied June 24, 1970.

Action to recover franchise taxes. The Superior Court, City and County of San Francisco, Edward Molkenbuhr, J., found for taxpayer and Franchise Tax Board appealed. The Court of Appeal, Devine, P. J., held that evidence established that corporate taxpayer's business was unitary with parent corporation.

Reversed with directions.

Thomas C. Lynch, Atty. Gen., Ernest P. Goodman, Asst. Atty. Gen., John J. Klee, Jr., Deputy Atty. Gen., San Francisco, for appellant.

Valentine Brookes, Charles S. Franklin, San Francisco, for respondent; Kent, Brookes & Anderson, San Francisco, of counsel.

DEVINE, Presiding Justice.

Franchise Tax Board of the State of California (herein, the Board) appeals from a portion of a judgment in the amount of $231,257.32 plus interest, which was awarded to

plaintiff in this lawsuit to recover taxes paid under protest. The taxes are upon the franchise to do business in California during the years 1954, 1955 and 1956; but in order to make the reading easier, operations and relationships among companies are sometimes narrated, in this opinion, in the present tense.

Plaintiff, Chase Brass and Copper Co., Incorporated, is a wholly owned subsidiary of Kennecott Copper Corporation. The principal question is whether plaintiff's business is unitary or nonunitary with Kennecott, and a lesser question is whether plaintiff's business is unitary with any of Kennecott's other subsidiary corporations. If the business be unitary, a much larger franchise tax would be imposed than if the business be nonunitary. It is not always unfavorable as to tax for a corporation to conduct a unitary business; for example, in the leading cases of Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406, 34 Cal.Rptr. 545, 386 P.2d 33, and Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417, 34 Cal.Rptr. 552, 386 P.2d 40, the corporations asserted, successfully, that their California operations were unitary with those conducted outside the state.

In the case before us, plaintiff computed its California income, using an allocation formula which is applied to nonunitary enterprises and which takes into account sales, property and payroll within the state as compared with those existing outside. The Board disagrees with this method of computation; it has assessed taxes at a much higher figure on the "unitary business" theory.

The Corporations

The parent is Kennecott Copper Corporation (called Kennecott herein), the nation's largest producer of copper,

a New York corporation. It does no business in California. It mines, smelts and refines copper, gold, silver and molybdenite. The metals are mined in Utah, Nevada, Arizona and New Mexico. Metals other than copper are sold in operations completely unrelated to plaintiff. Copper is not fabricated by Kennecott, but is sold through a subsidiary of Kennecott, Kennecott Sales Corporation.

Braden Copper Company, a Maine corporation, wholly owned by Kennecott, operates mines in Chile. Ordinarily, it sold copper to the government of Chile and to purchasers in the world market, but not to buyers in the United States. In the years relevant hereto, however, because of shortages, it did sell, through Kennecott Sales Corporation, in this country. Plaintiff was a buyer. Braden does not fabricate; it sells fungible copper.

Bear Creek Mining Company, a Delaware corporation, owned by Kennecott, explored for metals in California in the relevant years, but made no significant discoveries. It is the third company in the mining group consisting of Kennecott, Braden, Bear Creek.

The procedure beyond mining and refining of copper, sales, is committed to Kennecott Sales Corporation (herein, Kennecott Sales), a New York corporation, wholly owned by Kennecott, which in 1934 took over the sales and activity theretofore assigned by Kennecott and Braden to an independent agency. The sale of copper by Kennecott and by Braden within the United States is done by Kennecott Sales. No sales are made in California; Kennecott does no business here. Its sales of copper which enters this state are completed elsewhere. Kennecott Sales charges Kennecott a commission on the sales.

Kennecott Wire and Cable Co. (herein, Kennecott Wire), a Rhode Island corporation, owned by Kennecott, manu-

factures copper rod, wire and cable for transmission of electricity. It uses refined primary copper, all of which it buys from Kennecott or Braden through Kennecott Sales. Its sales operation in California is largely through plaintiff. Kennecott Wire did not do business in California in the relevant years.

Finally, there is plaintiff, Chase Brass and Copper Co., Incorporated, a Connecticut corporation, wholly owned by Kennecott. Like Kennecott Wire, it is a manufacturer. Its products are brass (made of copper and zinc), bronze (copper and alloys, mostly tin), and copper rod, sheet, wire and tube. The manufacture is done entirely outside California. Copper is bought from Kennecott Sales, derived from Kennecott and Braden, to the extent of 80 to 84 percent of Chase's needed supply. Within California, Chase warehouses and sells its products and those of Kennecott Wire.

The Franchise Tax Law

When a corporation engages in multistate business, including business in California, and the business is unitary, there must be an allocation of income by formula. Separate accounting is not allowable, although it is usable for a corporation which, by operating here and elsewhere, conducts a nonunitary business. In the case of Chase itself, it was always recognized by the company that its own business is unitary, wherefore its own computation of the franchise tax was done according to formula. But the Board contends that the geographic unitary character of Chase is not all that is to be considered; there must also be taken into account the whole intercorporate parentage and affiliation of the Kennecott family. Mainly, it is the vertical aspect which is put before us: the relationship of Chase to Kennecott Sales, to Braden and to Kennecott. Secondarily, there is to be considered the horizontal relationshp of Chase to Kennecott Wire.

Intercorporate unitary character of business, in which the activities of the parent are considered, under an appropriate factual situation, is a valid concept for taxing purposes. (Edison California Stores v. McColgan, 30 Cal.2d 472, 183 P.2d 16.) This holding of the *Edison Stores* case was but a logical sequence of the holding in Butler Brothers v. McColgan, 17 Cal.2d 664, 111 P.2d 334, in which a single company had operated through wholly controlled branches. In both cases, there were strong and embracing central controls. The general test which we are to apply is this: "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary." (Edison California Stores v. McColgan, *supra,* 30 Cal.2d at p. 481, 183 P.2d at p. 21; Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406, 412, 34 Cal.Rptr. 545, 386 P.2d 33.) A more particular statement of the test is that a business is unitary if these circumstances are present: "(1) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use of its centralized executive force and general system of operation." (Butler Brothers v. McColgan, *supra,* 17 Cal.2d at p. 678, 111 P.2d at p. 341; Superior Oil Co. v. Franchise Tax Board, *supra,* 60 Cal.2d at p. 412, 34 Cal.Rptr. 545, 386 P.2d 33.)

In applying these tests, we are considering a question of law only, because the facts, as placed before the trial court and before us, consist of a lengthy stipulation between the parties and some uncontradicted testimony. We must, therefore, make our own judgment on the question of law, and we cannot rest upon findings of fact made by the trial judge. (Standard Register Co. v. Franchise Tax Board, 259 Cal. App.2d 125, 129-130, 66 Cal.Rptr. 803; Household Finance

Corp. v. Franchise Tax Board, 230 Cal.App.2d 926, 930, 41 Cal.Rptr. 565; Montgomery Ward & Co. v. State Board of Equalization, 272 A.C.A. 823, 828-829, 78 Cal.Rptr. 373. See also RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal.App.2d 812, 816, 55 Cal.Rptr. 299; Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406, 414, 34 Cal.Rptr. 545, 386 P.2d 33.)

Unity of Ownership

As is usual in disputes of this kind, ownership of one corporation by another is present. This means, of course, that the owner (its stockholders and directors) expects, or at least hopes, that its subsidiary will make a profit. But more is required for a business to be unitary, that is, fulfillment of the other two tests.

Unity of Operation

Although there is not a clear demarcation between what is "operation" and what is "use," in general it may be said that the acts falling within the category of "operation" are the staff functions, and those within "use" are the line functions.

The staff functions of a vertically integrated enterprise probably are not so markedly unitary as they are in a horizontally integrated business. This is so because, in the case of horizontal integration, functions such as central control of advertising of the same product, central purchasing, and the like are designed to give advantages to the business despite geographic differences. In the case of vertical integration involving various steps in the production and distribution, integration of staff functions probably will be considerably less. Nevertheless, when we consider each of the functions of Chase coming under the heading

"Unity of Operations," in connection with those of its parent, Kennecott, we find considerable cooperation.

Purchasing: Under this heading, we consider the buying of items other than the purchase of copper, because copper buying is an essential "line" function. As to the auxiliary supplies, it is stipulated that Chase had its own purchasing department staffed by its own personnel. But Kennecott does some "minor" purchasing for Chase. In some instances, insurance was purchased for two or more companies in order to obtain a more favorable rate or better coverage or a better spread of risk. There was no intercompany coverage on basic industrial policies such as fire, fire use and occupancy, workmen's compensation, public liability, automobile liability and fire, sickness and accident, hospitalization and surgical, and certain types of bonds.

Advertising: Chase maintains its own advertising program and budget. The name and trademark of Chase are predominant in its advertisements, but these often contain a statement that Chase is a subsidiary of Kennecott. When Chase places advertising through an advertising agency, it uses the same agency that is used by Kennecott.

Accounting: Kennecott and Chase keep separate books of account, but the two use the same accounting firm. Kennecott prepared consolidated tax accounts for Chase.

Legal: Chase has its own legal staff and on occasion employs its own outside counsel. Presentation of the protest of Chase before the Franchise Tax Board in these proceedings was handled by Kennecott employees.

Financing: In 1955, Chase's mill at Waterbury, Connecticut, was severely damaged by flood. Kennecott made loans to Chase, in the amount of $10,000,000, for rehabilitation of the plant. The prime bank rate of interest, which was then three and a half percent, was charged. The loan,

including interest, was repaid within four years. We find this to be substantial evidence of unity of operation. It may be that Chase could have borrowed the money from lending institutions, but the fact remains that it could turn readily to its parent for help. It must have been deemed advantageous to the over-all management to have handled the transaction in this way, otherwise a separate arrangement would have been made.

Retirement Plan: There is a common retirement plan for salaried employees, which is administered by Kennecott, because when it was installed it appeared to be more economical and because it assures salaried employees in each company the same treatment as those in other Kennecott companies.

Unity of Use

Unity of use relates to executive forces and operational systems. (Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406, 415, 34 Cal.Rptr. 545, 386 P.2d 33.)

Executive Forces: The integration of executive forces is an element of exceeding importance. It is top level management which is credited (or, in case of failure or indifferent results, debited) with the effects of corporate enterprises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource. The stipulation of facts reads: "The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The

Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." The "major policy matters" are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott.

Not only was there opportunity for control at the highest levels. The salaries of Chase's executives (and of those of Kennecott Wire) who earned more than $15,000 a year were subject to review by Kennecott. Exercising regulations of salaries of Chase's executives, even of those who were compensated at a not particularly sizable figure, Kennecott could control costs of management. Besides, these executives could hardly fail to recognize that their compensation was dependent upon the decision of Kennecott's salary committee.

It is true that the president of Chase had a complete staff and line organization under his direction, but executive control at the highest level was in Kennecott.

Chase and Kennecott Wire: Inextricably bound to Chase's vertical relationship with Kennecott is its horizontal tie with Kennecott Wire. In fact, the relationships between Chase and Kennecott Wire, described in this paragraph, are evidence of the central control of these sibling corporations by their parent, Kennecott. Who would decide

the extent of the horizontal relationships and whether the joint activities were mutually advantageous to the siblings, and commonly so to the parent, but the parent itself? Kennecott Wire, like Chase, is a manufacturer. Since 1944, Chase has taken over the sales of the major part of the products of Kennecott Wire. Chase warehouses the products of Kennecott Wire; Chase salesmen call on prospective wire and copper customers. If the salesmen obtain orders, they send them to Kennecott Wire. The orders are filled and shipped in the name of Chase. Chase receives a discount on the products sold. Chase does much of the accounting and reviews the taxes for Kennecott Wire. The former president and the general sales manager of Kennecott Wire had been Chase employees. Although the products, all of them composed to some extent of copper, are different, the activities clearly show a unitary business. (RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal.App. 2d 812, 55 Cal.Rptr. 299.) Respondent argues that unity of ownership is absent. In form this is correct, but in substance the unity of ownership is present because Kennecott is the sole owner of Chase and of Kennecott Wire.

Purchase of Copper: Kennecott sells about 20 percent of its total copper production to Chase through Kennecott Sales. During the relevant years, there was an industry-wide copper shortage so that Kennecott would have had no difficulty in selling copper to others. This does not mean, however, that there was no contribution at all to Kennecott by Chase except the profits which Chase might make and which would redound to the benefit of Kennecott as sole stockholder. Although the three years, 1954, 1955 and 1956, are the only ones involved in the present case, these years are not the only ones in which the two corporations have been interested for their anticipated prosperity. Chase has

been owned by Kennecott since 1929. To have a buyer of a substantial portion of the parent's production throughout the years must be assumed to be an advantage.

It is the position of respondent that Chase gained no particular advantage during the years in question by reason of the parentage of Kennecott. Kennecott sold to Chase at exactly the same price as that which it charged Chase's competitors. Moreover, during the period of shortage an allocation was made based on prior sales. Respondent does not contend that price equality was the result of benevolence toward other consumers, including competing companies. The equality was under compulsion of the Robinson-Patman Act (15 U.S.C. § 13a). But it is argued that under these conditions Chase is no more unitary with Kennecott than is, for example, another large buyer from Kennecott, Revere Copper & Brass Company. Here, again, however, we remark that the three years are not the only ones to be considered. The percentage which governed the amount of copper allocable to Chase was built over the years.

The fact of the sales alone, however, whether specially advantageous to Kennecott or to Chase, does not determine the business to be unitary. The factors described under headings above, and particularly those relating to control of major policy, together with the subject of sales, bring us to the conclusion that the business among Kennecott, Kennecott Sales and Chase is unitary.

Except for the matter of sales and joint ownership, Braden and Chase are not unitary. We support the conclusion of the trial judge to this extent. As to Bear Creek, too, there is no such relationship as would allow formula computation of the taxes on the unitary theory. We agree with respondent on another point, namely, that Kennecott's sales of gold, silver and molybdenite metals, which are not bought

by Chase or Kennecott Wire, are not part of the unitary business. The fact that these metals come from the same ore as that which produces copper is not sufficient to cause their sales to be included in the computations which are to follow.

The Board concedes that there is error in the property factor as it was applied, because of the decision in McDonnell Douglas Corp. v. Franchise Tax Board, 69 Cal.2d 506, 72 Cal.Rptr. 465, 446 P.2d 313; wherefore, the case must be remanded in any event. Our decision requires further revisions of the formula.

We reverse the judgment, with directions to the trial court to proceed in accordance with this opinion.

RATTIGAN and CHRISTIAN, JJ., concur.

OPINION ON DENIAL OF PETITION FOR REHEARING

PER CURIAM.

This is in response to requests by the parties for further rulings and explanation:

1. The formulary taxation procedure is not in itself a simultaneous process of taxing and of disregarding the separate entity of the taxed corporation. (Edison California Stores v. McColgan, 30 Cal.2d 472, 481, 183 P.2d 16.)

2. We do not regard the case of Norfolk & Western Ry. Co. v. Missouri State Tax Comm., 390 U.S. 317, 88 S.Ct. 995, 19 L.Ed.2d 1201, to be decisive or even relevant to the case at hand. In the *Norfolk* case, the railroad was able to show, by actual count of its rolling stock on the lien date, that the number of units within Missouri was substantially less than that which had been assumed by the taxing authorities, and that a certain "enhanced value" theory proposed by the taxing authorities would require a challenge to a

total value figure which had been agreed upon. The case is far removed from the present one, wherein the operations of the corporations are unitary and separate accounting is not permitted.

3. Since the formula must be recomputed, the special issues relating thereto, which our opinion has not resolved, are to be presented to and tried by the trial court (the subject of the gold, silver and molybdenum operations, however, has been decided by our opinion).

The petition for rehearing is denied.

Appendix C

Filed Oct 31 1975
CARL M. OLSEN, Clerk

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 538-595

CHASE BRASS & COPPER CO., INCORPORATED,
Plaintiff,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

FINDINGS OF FACT

Findings of fact are appropriate on "[u]pon the trial of a question of fact by the court." Rule 232, California Rules

of Court. The evidence in this case came in primarily by way of stipulations of facts and agreed-upon documents, supplemented by uncontroverted testimony. The decisions which must be made by this Court do not involve the determination of factual disputes; rather, they involve the legal conclusions which follow from those undisputed facts. Accordingly, the Court makes no findings of facts.

CONCLUSIONS OF LAW

1. *Unitary Income.* This Court is required, pursuant to the decision of the Court of Appeal, to recompute unitary income to, *inter alia,* remove therefrom the net income attributable to the sales of metals other than copper. This Court concludes that, under the doctrine of "law of the case", it is required to use the Net Profit figures contained in Finding 2(h) made by Judge Molkenbuhr following the initial trial in this case. This Court believes, however, that the use of such figures for the net income from the sales of metals other than copper is erroneous and produces the ludicrous result that the depletion allowances and other expenses attributable to metals other than copper are allowed as expenses of the copper business, thus understating the amount of unitary net income of the copper business. This Court would like to remedy this error but feels that it does not have the authority to do so within the scope of the remand.

The other adjustments to unitary income mandated by the Court of Appeal decision are not disputed.

2. *Four-Factor Allocation Formula.* In apportioning the unitary income, as adjusted, the Board used the three-factor formula of property, payroll and sales traditionally applied to manufacturing-selling businesses. Plaintiff suggests that a fourth factor of "manufacturing" or "mining"

must be used. This Court concludes that the use by the Board of the three-factor formula does not produce arbitrary results and is consistent with due process and section 25101 of the Revenue and Taxation Code.

3. *Allocation Formula Factor Adjustments*

A. *Value of Mines for Property Factor Purposes.*

In recomputing the property factor of the allocation formula, the Board has included the mining properties of Kennecott Copper Corporation at their net book value, which is stipulated to be their cost to Kennecott. Plaintiff argues that such properties must be included in the property factor at their fair market value. This Court concludes that the inclusion of such properties in the property factor at net book value (cost) was fair and consistent with due process and section 25101 of the Revenue and Taxation Code.

B. *Removal From Allocation Formula Factors of Property, Payroll and Sales Attributable to Metals Other Than Copper.*

In making its recomputations, the Board made adjustments to the property, payroll and sales factors to reflect the fact that income from sales of metals other than copper had been removed from unitary income. The manner in which the adjustments were made to the property and payroll factors is described in the Stipulation filed October 3, 1975. This Court concludes that the method followed by the Board was fair and consistent with due process and section 25101 of the Revenue and Taxation Code.

4. As a result of the adjustments described above, together with the adjustments which both parties agree must be made, plaintiff is entitled to a refund of franchise tax in the sum of $6,519.41 for the year 1954; the sum of $23,146.83 for the year 1955; and the sum of $27,912.53 for

the year 1956, plus the interest paid thereon, together with interest on the entire overpayment, as provided by section 26107 of the Revenue and Taxation Code.

5. Plaintiff is awarded its costs of suit.

6. Net judgment be entered accordingly.

DATED: OCT 31, 1975

Victor Campilongo,

JUDGE OF THE SUPERIOR COURT

FILED
OCT 31 1975
CARL M. OLSEN, Clerk
By .....
Deputy Clerk

ENTERED
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OCT 31 1975
CARL M. OLSEN, Clerk
By A. Gentle
Deputy Clerk

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 538-595

CHASE BRASS & COPPER CO., INCORPORATED,
Plaintiff,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Defendant.

JUDGMENT

IT IS HEREBY ADJUDGED, ORDERED AND DECREED that plaintiff recover from defendant the sum of $6,519.41 for the year 1954; the sum of $23,146.83 for the year 1955; and the sum of $27,912.53 for the year 1956, plus the interest paid thereon, together with interest on the entire overpayment, as provided by Section 26107

of the Revenue and Taxation Code, together with its costs of suit in the sum of $.....

DATED: OCT 31, 1975

Victor Campilongo,
JUDGE OF THE SUPERIOR COURT

Appendix D

CHASE BRASS & COPPER CO., INC.,
Plaintiff, Respondent and Appellant,

v.

FRANCHISE TAX BOARD of the State
of California, Defendant, Appellant
and Respondent.

Civ. 38789.

Court of Appeal, First District,
Division 2.

June 7, 1977.

As Modified on Denial of Rehearings
July 7, 1977.
Hearing Denied Aug. 11, 1977.

After remand for retrial and recomputation, 10 Cal.App. 3d 496, 95 Cal.Rptr. 805, the Superior Court, City and County of San Francisco, Victor Campilongo, J., entered judgment for recovery of corporate franchise taxes, plus interest, for years in question, and both taxpayer and Franchise Tax Board appealed. The Court of Appeal, Taylor, P. J., held that: (1) determination on prior appeal that "other metals" business of taxpayer's parent corporation was not a part of a unitary business and, hence, was not subject to an allocation of income by formula was law of

case as to Board and operated to preclude a redetermination of issue; (2) court below acted within scope of mandate on remand when, on basis of law of case, it prohibited introduction of new evidence as to net income from metals other than copper to be used in recomputing unitary net income; (3) determination of Board to apply a traditional three-factor property-payroll-sales formula and to reject a fourth "expenses of manufacturer" factor in computing unitary net income was not an abuse of discretion; (4) use of actual original costs, rather than fair market value, for property factor was a logical and reasonable approach and was such as to meet "rough approximation" standard applicable in situation; (5) computations of payroll and sales factors were neither arbitrary nor unfair; (6) joint-products approach used by Board in making required adjustments to property, payroll and sales factors of allocation formula was not unreasonable, and (7) payroll and property were properly apportioned, not on basis of sales value, but on basis of weight of the copper and other metals.

Affirmed.

Evelle J. Younger, Atty. Gen. of Cal., Ernest P. Goodman, Asst. Atty. Gen., Timothy G. Laddish, Deputy Atty. Gen., San Francisco, for Franchise Tax Board of California.

Valentine Brookes, Lawrence V. Brookes, San Francisco, for Chase Brass & Copper Co., Inc.

TAYLOR, Presiding Justice.

Both the taxpayer, Chase Brass & Copper Co., Inc. (hereafter Chase) and the state Franchise Tax Board

(hereafter Board) appeal[1] from a 1975 judgment in the total amount of $57,578.77[2] for the recovery of corporate franchise taxes, plus interest, for the years 1954, 1955 and 1956. The 1975 judgment was entered after retrial and recomputation pursuant to the limited remand of this court (Division Four) in *Chase Brass & Copper Co. v. Franchise Tax Bd.*, 10 Cal.App.3d 496, 95 Cal.Rptr. 805 (hereafter *Chase I*). We have concluded that: 1) the court below acted within the scope of the remand; 2) as to the Board, the doctrine of the law of the case was properly applied as to the "other metals" and prevents redetermination of that issue here; 3) the Board did not abuse its discretion in using a three-factor formula of sales, property and payroll to determine the allocation of Chase's income to California and in using cost rather than fair market value for the property factor; and 4) the method of recomputation used by the Board was not arbitrary or erroneous, and was fairly calculated to assign to California that portion of the net income of the unitary business reasonably attributable to the business done in this state.

In view of the posture of this appeal, we first restate the pertinent facts and issues determined in *Chase I*. On that appeal, as in the instant one, the facts were stipulated; accordingly, only questions of law were determined. Chase,

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1. Although the Board's notice of appeal is from the entire judgment, the major issues are the trial court's deletion of income from metals other than copper and the doctrine of the law of the case. Chase's cross-appeal is also from the entire judgment but is concerned primarily with the factors of the allocation formula and the Board's method of recomputation. Chase's initial appeal was dismissed.

2. The judgment allowed the following amount for each tax year in issue:

1954	$ 6,519.41
1955	$23,146.83
1956	$27,912.53

a Connecticut corporation, is a wholly owned subsidiary of Kennecott Copper Corporation (hereafter Kennecott), the nation's largest producer of copper, a New York corporation. Kennecott does no business in California; it mines, smelts and refines copper, gold, silver and molybdenite and other metals. The copper and other metals are mined in Utah, Nevada, Arizona and New Mexico. Metals other than copper are sold in operations completely unrelated to Chase. Copper is not fabricated by Kennecott, but is sold through a subsidiary of Kennecott, Kennecott Sales Corporation (hereafter Kennecott Sales). *Chase I* also involved the question of whether two other out-of-state Kennecott subsidiary corporations, Braden Copper Company (hereafter Braden) and Bear Creek Mining Company (hereafter Bear Creek), were part of the unitary business, as well as a goods-in-transit issue settled by the parties after *Montgomery Ward & Co. v. Franchise Tax Bd.*, 6 Cal.App.3d 149, 85 Cal.Rptr. 890.

Kennecott Wire and Cable Co. (hereafter Kennecott Wire), a Rhode Island corporation owned by Kennecott, manufactures copper rod, wire and cable for transmission of electricity. Kennecott Wire uses refined primary copper, all of which it buys from Kennecott through Kennecott Sales; Kennecott Wire's sales operation in California is largely through Chase. Kennecott Wire did not do business in California in 1954, 1955 and 1956.

Chase, like Kennecott Wire, is a manufacturer. Chase's products are brass (made from copper and zinc), bronze (copper and alloys, mostly tin), and copper rod, sheet, wire and tube. The manufacture is done entirely outside California. Chase buys 80-84 percent of its needed copper supply from Kennecott Sales, derived from Kennecott and Braden. In California, Chase warehouses and sells its products and those of Kennecott Wire.

The issues to be determined under the California Franchise Tax Law were summarized in *Chase I,* as follows, 10 Cal.App.3d at pages 501 and 502, 95 Cal.Rptr. at 807: "When a corporation engages in multistate business, including business in California, and the business is unitary, there must be an allocation of income by formula. Separate accounting is not allowable, although it is usable for a corporation which, by operating here and elsewhere, conducts a nonunitary business. In the case of Chase itself, it was always recognized by the company that its own business is unitary, wherefore its own computation of the franchise tax was done according to formula. But the Board contends that the geographic unitary character of Chase is not all that is to be considered; there must also be taken into account the whole intercorporate parentage and affiliation of the Kennecott family. *Mainly, it is the vertical aspect which is put before us; the relationship of Chase to Kennecott Sales, to Braden and to Kennecott. Secondarily, there is to be considered the horizontal relationship of Chase to Kennecott Wire.*

"Intercorporate unitary character of business, in which the activities of the parent are considered, under an appropriate factual situation, is a valid concept for taxing purposes. (*Edison Cal. Stores, Inc. v. McColgan,* 30 Cal.2d 472, 183 P.2d 16.) This holding of the *Edison Stores* case was but a logical sequence of the holding in *Butler Bros. v. McColgan,* 17 Cal.2d 664, 111 P.2d 334, in which a single company had operated through wholly controlled branches. In both cases, there were strong and embracing central controls. The general test which we are to apply is this: 'If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary.' (*Edison California Stores v. McColgan,* supra, 30 Cal.2d at p. 481, 183 P.2d at p. 21; *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 412, 34 Cal.Rptr. 545, 386 P.2d 33.)" (Emphasis added.)

After applying the three particulars of the test, Justice Devine in *Chase I,* at page 506, 95 Cal.Rptr. 805, disagreed with a portion of the lower court's holding, and held that the business of Kennecott, Kennecott Sales, Kennecott Wire and Chase was unitary and, therefore, subject to an allocation of income by formula. This resulted in an assessment of Chase's corporate franchise tax at a much higher figure as a result of the application of the "unitary business" theory.[3] At the same time, Justice Devine agreed with two of the parts of the lower court's holding, namely, that: 1) Chase's business was not unitary with two other foreign Kennecott subsidiary corporations, Braden and Bear Creek; and 2) "Kennecott's sales of gold, silver and molybdenite metals, which are not bought by Chase or Kennecott Wire, are not part of the unitary business." (*Chase I,* p. 506, 95 Cal.Rptr. p. 810.)[4]

In addition, as the Board conceded that there was an error in the application of the property factor as the result of the intervening decision of *McDonnell Douglas Corp. v. Franchise Tax Bd.,* 69 Cal.2d 506, 72 Cal.Rptr. 465, 446 P.2d 313, Justice Devine noted at page 506, 95 Cal.Rptr. at page 810 that "the case must be remanded in any event. Our decision requires further revisions of the formula."

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3. In the absence of the application of the unitary theory. Chase would have been permitted to recover $231,257.32 (*Chase I,* p. 499, 95 Cal.Rptr. 805).

4. Although the *Chase I* opinion specifically referred only to gold, silver and molybdenite, the parties agree that several other metals, selenium and platinum, are also involved. Accordingly, we use the collective term of "other metals."

The judgment was reversed with directions to proceed in accordance with the *Case I* opinion. On denial of the petition for rehearing, this court added the further rulings and explanations, set forth below, so far as pertinent,[5] at pages 506 and 507, 95 Cal.Rptr. at pages 810-811. Subsequently, the state Supreme Court denied Chase's petition for hearing (June 24, 1970) and the U.S. Supreme Court dismissed Chase's petition for lack of jurisdiction (400 U.S. 961, 91 S.Ct. 365, 27 L.Ed.2d 381). In both of these further review proceedings, the Board did not challenge the portion of the *Chase I* judgment holding that Kennecott's sales of the metals other than copper were not a part of the unitary business.

Preliminarily, we turn to the issues pertaining to the scope of review on this appeal. At the retrial, the court, on the basis of the law of the case, prohibited the introduction of new evidence as to the net income from the metals other than copper to be used in recomputing the unitary net income; the court used the figures contained in *finding 2(h)*

5. "1. The formulary taxation procedure is not in itself a simultaneous process of taxing and of disregarding the separate entity of the taxed corporation. (*Edison California Stores v. McColgan*, 30 Cal.2d 472, 481 [183 P.2d 16].)

"2. We do not regard the case of *Norfolk & Western Ry. Co. v. Missouri State Tax Com.*, 390 U.S. 317 (88 S.Ct. 995, 19 L.Ed.2d 1201), to be decisive or even relevant to the case at hand. In the *Norfolk* case, the railroad was able to show, by actual count of its rolling stock on the lien date, that the number of units within Missouri was substantially less than that which had been assumed by the taxing authorities, and that a certain 'enhanced value' theory proposed by the taxing authorities would require a challenge to a total value figure which had been agreed upon. The case is far removed from the present one, wherein the operations of the corporations are unitary and separate accounting is not permitted.

"3. Since the formula must be recomputed, the special issues relating thereto, which our opinion has not resolved, are to be presented to and tried by the trial court (***the subject of the gold, silver and molybdenum operations, however, has been decided by our opinion***)." (Emphasis added.)

of the *Chase I* trial court decision,[6] which had been challenged on the *Chase I* appeal. However, in its first conclusion of law, the court after the retrial stated that the use of these figures for "the net income from the sales of metals other than copper is erroneous and produces the ludicrous result that the depletion allowances and other expenses attributable to metals other than copper are allowed as expenses of the copper business, thus understating the amount of unitary net income of the copper business. This Court would like to remedy this error but feels that it does not have the authority to do so within the scope of the remand."

On this appeal, the Board first maintains that the lower court's limited interpretation of the scope of the remand on the retrial constituted reversible error. The Board argues that a finding of fact, as distinct from a conclusion of law, cannot be the basis for the application of the doctrine of the law of the case and, in any event, the rule is only a procedural one that does not go to the power of the court and should not be adhered to where its application

6. "In the years in question, Braden had net profit on molybenite [sic] and Kennecott had net profit on metals other than copper, principally gold, silver and molybdenite, in the following amounts:

	1954	1955	1956
Braden	$ 1,786,328.29	$ 2,633,771.88	$ 2,611,516.06
Kennecott	30,321,857.61	32,743,300.57	34,835,182.66
	$32,108,185.90	$35,377,072.45	$37,446,698.72

"For purposes of this finding, 'net profit' means gross sales price less direct expenses incurred after the particular metal has been separated from the copper. 'Net profit' does not take into consideration any indirect expenses, such as overhead, or any direct expenses incurred in the mining, concentrating or smelting of the ore prior to the time the copper bearing material is separated from the material containing these other metals; for internal accounting purposes, Kennecott treats all such direct expenses and indirect expenses as costs of producing copper."

will result in an unjust decision (*People v. Scott,* 16 Cal.3d 242, 246, 128 Cal.Rptr. 39, 546 P.2d 327, reiterating *People v. Shuey,* 13 Cal.3d 835, 845, 120 Cal.Rptr. 83, 533 P.2d 211).[7]

We, however, agree with Chase's contention that in the instant case, the determination that Kennecott's "other metals" business was not a part of the unitary business, was one of law. As clearly indicated in *Chase I,* 10 Cal.App.3d at page 502, 95 Cal.Rptr. 805, the facts were stipulated or uncontroverted[8] and the only issues before the court were questions of law. Nor do we think that under the particular circumstances of this case there was demonstrated such a "manifest misapplication of existing principles resulting in substantial injustice" (*People v. Shuey, supra,* 13 Cal.3d p. 846, 120 Cal.Rptr. p. 91, 533 P.2d p. 219) as to permit us to disregard the legal determination made on the "other metals" issue in *Chase I.*

In any event, as indicated above, the Board did not challenge this portion of the ruling, including the use of the 2(h) finding on the appeal of *Chase I* or during the further review of Chase. Thus, as to the Board, the determination excluding the net income from the other metals is the law of the case (*Gore v. Bingaman,* 20 Cal.2d 118, 112-124, 124 P.2d 17; *Pillsbury v. Superior Court,* 8 Cal.2d 469, 471-472, 66 P.2d 149), and the Board is precluded from raising the

7. In essence, the doctrine provides that when an appellate court has rendered a decision, that rule is to be followed in all subsequent proceedings in the same action (*People v. Scott,* supra, at p. 246, 128 Cal.Rptr. 39, 546 P.2d 327, citing *People v. Shuey,* supra, pp. 840-848, 120 Cal.Rptr. 83, 533 P.2d 211).

8. The record indicates that finding of fact 2(h) was based on Chase's exhibit that was not controverted by the Board. There was no other evidence before the court on this issue. The Board objected to the introduction of the exhibit but did so solely on grounds of relevancy; this ground, of course, does not go to the truth of the matter.

matter here as to the three tax years in issue. Even assuming an error, as did the court below, the other metals issue was tried and resolved on the basis of uncontroverted evidence and determined in the first appeal; accordingly,[9] that portion of the *Chase I* judgment is binding and conclusive. We see no fundamental error or injustice that requires a reexamination of the issue reached on the first appeal (*Gore v. Bingaman,* supra, 20 Cal.2d p. 123, 124 P.2d 17). We merely hold here that in our view, the instant case is not a proper one for the application of any of the exceptions to the doctrine of the law of the case.

Chase, in turn, attempts to relitigate the portion of the *Chase I* judgment determining its income was unitary with Kennecott and Kennecott Sales. For this contention, Chase relies on *Kennecott Copper Corp. v. State Tax Com'n.,* 27 Utah 2d 119, 493 P.2d 632, appeal dismissed 409 U.S. 973,[10] 93 S.Ct. 323, 34 L.Ed.2d 237, decided by the Supreme Court of Utah after *Chase I.* We recognize that an intervening or contemporaneous change in the law or the establishment of a new precedent by controlling authority is one of the recognized exceptions to the rule of the law of the case (*Ryan v. Mike-Ron Corp.,* 259 Cal.App.2d 91, 97, 66 Cal.Rptr. 224). However, the Utah decision is not controlling as to this court; also, it is based on the application of separate accounting principles to the unitary business, which are

9. Thus, we do not deal with the Board's contentions that Revenue and Taxation Code section 24425 requires that some of the common expenses allocable to the "other metals" including depletion, must be deducted and that new evidence adduced at the retrial indicated that there was, in fact, no separate "other metals" business.

10. Although the Utah court held that Kennecott was unitary with Chase and its other subsidiaries, and thus consistent with *Chase I,* both Chase and the Board agree that the Utah case was wrongly decided and joined in the appeal to the U.S. Supreme Court.

contrary to the law of this state, as set forth in *Superior Oil Co. v. Franchise Tax Bd.*, 60 Cal.2d 406, 416, 34 Cal.Rptr. 545, 386 P.2d 33, and *Honolulu Oil Corp. v. Franchise Tax Bd.*, 60 Cal.2d 417, 425, 34 Cal.Rptr. 552, 386 P.2d 40.

Chase's reliance on intervening decisions of the State Board of Equalization[11] is equally inapposite. Nor is there any merit to Chase's additional contention that the unitary income determination of *Chase I* is not the law of the case before us because of Chase's federal constitutional objections to the validity of the allocation formula devised on remand. *People v. Scott*, 16 Cal.3d 242, 128 Cal.Rptr. 39, 546 P.2d 327, and *People v. Shuey*, 13 Cal.3d 835, 120 Cal.Rptr. 83, 533 P.2d 211, clearly indicate that the presence of federal constitutional questions does not eliminate the rule of the law of the case. As the California Supreme Court denied Chase's petition for a hearing, the unitary business determination of *Chase I* is the law of the case on this appeal.

We turn, therefore, to the main issues presented on this appeal pertaining to the Board's use of: 1) the three-factor formula, 2) Chase's book value for the property factor; and 3) the method of recomputation of Chase's tax liability. We note that as to each of these matters, the court below, after the remand, concluded that the Board's action was fair and

11. We take judicial notice of these decisions pursuant to Evidence Code section 453, only for the purpose of disposing of Chase's argument. The record thus indicates that the Board of Equalization's first decision in Appeal of Harbison-Walker Refractories Company, California Tax Reports, 204-294, was rendered several days after *Chase I*. Thereafter, the Board of Equalization decided to rehear the matter for two reasons: *Chase I*, and doubts as to whether the facts had been fully developed by the parties. At the rehearing, new facts supporting a unitary holding were developed and the Board of Equalization, on a consideration of all of the facts, held that the unitary business tests had been satisfied, and cited *Butler Brothers v. McColgan*, 17 Cal.2d 664, 111 P.2d 334, affirmed 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991, and *Edison California Stores v. McColgan*, 30 Cal.2d 472, 183 P.2d 16.

consistent with due process and Revenue and Taxation Code section 25101.

At the time of the tax years here in issue, former Revenue and Taxation Code section 25101 provided, so far as pertinent: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. *Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State* . . .; provided, however, that any such factors or other method of allocation shall take into account as income derived from or attributable to sources without the State, income derived from or attributable to transportation by sea or air without the State, whether or not such transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country." (Emphasis supplied.)

Pursuant to the statute, the Board applied the traditional three-factor property-payroll-sales formula, computed as described in the footnote below.[12] (See Wahrhaftig, Allocation Factors in Use in California, 12 Hastings L.J., 65, 73-76.)

12. "The percentage of the firm's total real property and tangible personal property in California is computed; the percentage of the firm's total payroll of wages, salaries and commissions paid to employees in California is computed; the percentage of the firm's gross sales, less returns and allowances, in California is computed. The three percentage figures are totaled and the resulting sum is then divided by three. The final figure applied to total business income represents the percentage of the total net business income of a firm which can be allocated to California."

Chase argues that since the statute permitted the use of other additional factors, the Board should have used a fourth "expenses of manufacture" factor.[13] However, the Board's discretion to use the three-factor formula has been upheld by an unbroken series of California decisions. In *Edison California Stores v. McColgan,* 30 Cal.2d 472, 183 P.2d 16, our Supreme Court declared (at p. 479, 183 P.2d 16) that the overall fairness of the three-factor property, payroll and sales formula was settled. *John Deere Plow Co. v. Franchise Tax Bd.,* 38 Cal.2d 214, 222, 238 P.2d 569, appeal dismissed 343 U.S. 939, 72 S.Ct. 1036, 96 L.Ed. 1345 held the same for the vertically integrated manufacturing and selling business there involved. In *El Dorado Oil Works v. McColgan,* 34 Cal.2d 731, 215 P.2d 4, dismissed 340 U.S. 801, 71 S.Ct. 52, 95 L.Ed. 589, the taxpayer argued that a five-factor formula was necessary. In rejecting this contention, our Supreme Court construed the predecessor of former Revenue and Taxation Code section 25101, and said 34 Cal.2d at page 737, 215 P.2d at page 8: "On the contrary, the broad language of the section indicates that *the factors therein designated are suggestive, but not mandatory or exclusive,* and that the commissioner is empowered in his discretion to choose such tax base for his formula allocation as will carry out the act's purpose to achieve a proper apportionment of business done within and without the state, and at the same time avoid double taxation." (Emphasis added.)

In *McDonnell Douglas Corp. v. Franchise Tax Bd.,* 69

13. Chase has never explained how the denominator of the expenses of manufacture factor would be computed as the unitary business did no manufacturing in California. Thus, the numerator of the manufacture formula would be zero and the total of the property, sales and payroll factors would be divided by four, resulting in a lower allocation percentage.

Cal.2d 506, 72 Cal.Rptr. 465, 446 P.2d 313, our Supreme Court emphasized, at page 515, 72 Cal.Rptr. 465, 446 P.2d 313, that it was not empowered to select the factors. More recently, the applicable rules were summarized by this court (Division One) in *Montgomery Ward & Co. v. Franchise Tax Bd.,* 6 Cal.App.3d 149, at page 155, 85 Cal.Rptr. 890, at page 895, as follows: "'Discretion as to the factors to be used was placed in the commissioner and his successor, the Franchise Tax Board. As stated in *RKO Teleradio Pictures, Inc. v. Franchise Tax Board,* 246 Cal.App.2d 812, at page 819, 55 Cal.Rptr. 299, at page 304, . . .: "The Franchise Tax Board is given discretion in the selection of [the] factors to be utilized in a tax formula (*El Dorado Oil Works v. McColgan* [supra], 34 Cal.2d 731, 736, 215 P.2d 4, . . .) and where, as here, the taxpayer contends that the formula is arbitrary and reaches an unreasonable result, the burden is on the taxpayer to establish such facts by clear and convincing evidence." (See *Butler Bros. v. McColgan,* supra, 315 U.S. 501, 507 [62 S.Ct. 701, 86 L.Ed. 991, 996] . . .)' (69 Cal.2d at p. 512, 72 Cal.Rptr. at p. 468, 446 P.2d at p. 316, fn. omitted.)" In *Gen. Motors v. District of Columbia,* 380 U.S. 553, at page 559, 85 S.Ct. 1156, 14 L.Ed.2d 68, the U.S. Supreme Court approved the use of the three-factor formula by the great majority of states.

Chase here has not met its burden of establishing by clear and convincing evidence that the three-factor formula used is arbitrary and reaches an unreasonable result. It merely argues that the formula is intrinsically unfair. As our Supreme Court noted in *El Dorado Oil Works v. McColgan,* 34 Cal.2d 731, at page 739, 215 P.2d 4, at page 9: ". . . it necessarily must be concluded that defendant's application of the three-factor formula as a preferred general practice is not open to objection as an unauthorized exercise of

power so long as it produces the desired proportionate result directed by the statute and at the same time avoids subjecting the taxpayer to double taxation."[14]

Chase's additional contention that by the use of the three-factor formula more income has been allocated to California than the California portion of the unitary business could possibly earn, is equally without merit. This contention is based on treating Chase as a separate and independent entity with a separate accounting system. As indicated by the quotation from *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal.2d 214, 223, 238 P.2d 569, quoted below at page 912, this argument disregards the basic concept of a unitary income—namely, that the unitary income is the result of the function of the entire unitary business to which each element contributes. As stated in *Chase I*, 10 Cal.App.3d at page 507, 95 Cal.Rptr. 805, separate accounting is not permitted for the unitary business of the corporations, and the contention therefor has been repeatedly rejected (*John Deere*, supra, 38 Cal.2d p. 229, 238 P.2d 569; *Edison California Stores, Inc. v. McColgan*, 30 Cal.2d 472, at pp. 479 and 482, 193 P.2d 16, citing *Butler Brothers v. McColgan*, 17 Cal.2d 664, 111 P.2d 334, and *Household Finance Corp. v. Franchise Tax Board*, 230 Cal.App.2d 926, 929, 41 Cal. Rptr. 565).

The U.S. Supreme Court in affirming the unitary assessment against Butler Brothers, said at 315 U.S. 507-508, 62 S.Ct. 704, 86 L.Ed. 991: "It is true that appellant's separate accounting system for its San Francisco branch attributed

14. *Culligan Water Conditioning v. State Bd. of Equalization*, 17 Cal.3d 86, 92, 130 Cal.Rptr. 321, 550 P.2d 593, cited by Chase, is clearly distinguishable from the instant situation where the courts have long approved and recognized the grant of discretionary power to the taxing body in the selection of the allocation factors.

no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121, 41 S.Ct. 45, 47, 65 L.Ed. 165, that a State in attempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' Furthermore, the particular system used may not reveal the facts basic to the State's determination. *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission*, supra, 266 U.S. [271] page 283, 45 S.Ct. [82] page 84, 69 L.Ed. 282. In either aspect of the matter, the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here."

We conclude that the Board properly used the three-factor formula and turn to Chase's contentions as to the purported unfairness of each factor as computed on remand.

As to the property factor, Chase contends that the Board erred in using actual original cost, rather than fair market value, for its mining properties. The parties agree that during the tax years here in issue, the Board computed the property factor by including all property at the tax basis of the taxpayer. As Kennecott's mining properties were

subject to percentage depletion, their tax basis was zero.[15] While *Chase I* was pending, the state Supreme Court held in *McDonnell Douglas Corp. v. Franchise Tax Bd.*, 69 Cal. 2d 506, 72 Cal.Rptr. 465, 446 P.2d 313, that all property used in producing the income subject to apportionment had to be reflected in the property factor.[16] Accordingly, the Board agreed that its original method of computing the property factor was wrong. In making the recomputation, the Board included the mining properties at original cost,[17] the very same value used by Kennecott for its own balance sheet. The parties further stipulated that the term "mining properties" included land and ore bodies in the land but *excluded milling and smelting plant and machinery.* Chase's proposed fair market value calculation of the mining properties, however, included the value of the plants and equipment. On this appeal, Chase also argues, contrary to the

15. The *Chase I* stipulation indicates that Kennecott's mining properties were initially included in the property factor at an amount of $46,000,000 for each of the three tax years here in issue.

16. Contrary to Chase's argument, *McDonnell,* supra, did not prescribe the use of fair market value for the property factor. In that case, the Board had followed its practice of including property at the tax basis of the taxpayer; thus, the property owned by the federal government and used by McDonnell Douglas rent free was not included in the property factor. The court held that since both the owned and nonowned property contributed to the production of income, the federally owned property could not be excluded. Subsequently, the Board recomputed the property factor and included the federally owned property by giving it a hypothetical tax base, i.e., its depreciated net book value to which McDonnell Douglas stipulated.

17. The Board indicated that since inventories and land are not depreciable, their amount was computed at cost. Chase's machinery and equipment in California were assessed at the same figure as the federal tax basis or net book value, i.e., cost less depreciation. As a result of the recomputation, the mining properties were included in the property factor at more than $106,000,000 for each of the three years here in issue, an upward adjustment of more than $60,000,000 annually.

record, that the book value used by the Board contains no element of cost or other value for the ore bodies.

Chase also argues that the term "value" as used in former Revenue and Taxation Code section 25101 can only be construed as fair market value. However, the term "value" has never been defined by the applicable statutes and is clearly not defined as "fair market value" in the Uniform Division of Income for Tax Purposes Act) (Rev. & Tax Code, §§ 25120-25139), adopted for use in this state for the income years beginning January 1, 1967. (Stats. 1966, ch. 2.)

Revenue and Taxation Code section 25130 now provides: "*Property owned by the taxpayer is valued at its original cost.* Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals." (Emphasis added.)

Thus, the statute equates "value" and "cost" rather than value and fair market value. Here, the Board's inclusion of Chase's mining properties at cost was a logical and reasonable approach to the three tax years here in issue that predated the present statute and met the "rough approximation" standard articulated as follows in *McDonnell Douglas Corp. v. Franchise Tax Bd.,* supra, at page 511, 72 Cal. Rptr. at page 467, 446 P.2d at page 315, quoting from *El Dorado Oil Works v. McColgan,* supra, 34 Cal.2d at page 741, 215 P.2d 4: "'No method of allocation can precisely determine the amount of income attributable either to any given geographic area or to any given part of a series of business transactions culminating in the realization of a profit, and "any effort" in that regard "must be more or less arbitrary and fictitious" (*Gorham Mfg. Co. v. Travis,* D.C., 274 F. 975, 978) as a matter of practical tax adminis-

tration. In short, as was recently said by the Supreme Court of the United States in sustaining the validity of a franchise tax assessment, the "practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities . . . [makes] 'rough approximation rather than precision' . . . sufficient" in the formula allocation of income from a unitary business. (*International Harvester Co. v. Evatt,* 329 U.S. 416, 422 [67 S.Ct. 444, 91 L.Ed. 390, 395].)' "

Chase's determination of fair market value based on Hoskold's Formula used by its witness, is necessarily also only a rough approximation as its own witnesses indicated. The Hoskold Formula used long range estimates into the next century of matters such as amount of production, sales income and costs of production. At the 1966 hearing, Chase's witness indicated that mines were "rarely actually transferred by buying or selling." At the 1972 hearing, Chase's witness Ward indicated that Kennecott's mining properties were chiefly acquired by tax free stock exchanges over a period of many years, and were carried over to Kennecott's books at the same cost as they had appeared on the books of the prior owner. The witness opined that as a result of this method of acquisition, the market value could not be determined. The same witness also indicated that the acquisition cost of a mine had no relationship to its profitability which depended on productivity and that the book value figures had to be adjusted upwards each year as more additional claims around the perimeter of existing mines were acquired to accommodate the inverted cone mining method used.

We conclude that the Board's adjustment of the value of Chase's mining properties was in accord with McDonnell Douglas, and not arbitrary or unfair to Chase.

We turn next to Chase's contentions concerning the payroll and sales factors. The record indicates that the Board computed the payroll factor by the standard method of comparing the salaries paid to California employees with the salaries paid to all employees of the unitary business.

Chase contends that this method was arbitrary and unfair as it did not take into account the fact that Kennecott's mining employees are more productive than Chase's fabrication and sales employees. We note that there is no factual evidence in the record to sustain this contention and that Chase's argument ignores the necessarily subjective determinations that underlie it.

In any event, where a unitary business operates across state lines, the profitability or productivity of one group of employees as against another, based on separate accounting in each state, is not relevant to the apportionment formula used for unitary business. In rejecting a substntially similar contention (namely, that income from the California portion of the business should not be computed by the apportionment formula as the California operations were not as profitable as the out-of-state ones), our Supreme Court said in *John Deere Plow Co. v. Franchise Tax Bd.,* 38 Cal.2d 214, at pages 223 and 224, 238 P.2d 569, at pages 573-574: "But in so arguing plaintiff fails to take into account the underlying concept of formula apportionment in the allocation of income from a unitary business: that the unitary income is derived from the functioning of the business as a whole, to which the activities in the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done within the state is not truly separate and distinct from the business done without the state so as reasonably to permit of a segregation of income under the separate accounting method rather than use of the formula method in assigning to the

taxing state its fair share of taxable values. [Citations.] As above stated, here the overall organization of Deere and Company was a manufacturing and selling business having its operations extending into a number of different states and providing an example of a typical unitary business subject to formula allocation as a reasonable method of apportionment for franchise tax purposes. [Citations.] The fact that the taxpayer may show that according to a separate accounting system, the activities in the taxing state were less profitable than those without the state, or even resulted in a loss, does not preclude use of a formula as a method of apportionment of the unitary income."

Contrary to Chase's contention, *Household Finance Corp. v. Franchise Tax Board,* 230 Cal.App.2d 926, 41 Cal.Rptr. 565, does not support its arguments. In *Household Finance* at page 930, 41 Cal.Rptr. 565, the court, on the authority of *John Deere,* supra, rejected the taxpayers' similar argument that its costs in California were higher than elsewhere because of the higher salaries paid here. Generally, Chase's contentions overlook the fact that a unitary business is one in which all parts contribute to the total profits in unmeasurable amounts. Thus, if the profits of any portion of the unitary business are separated from the rest, the base is necessarily inaccurate as the profits from any segment cannot be determined with certainty.

As to the sales factor, the record indicates that the Board excluded sales from one member of the unitary group to another, as no net income is realized as a result of the internal sales. Thus, the sales factor only included sales to outside purchasers. Chase argues that the sales factor as so computed erroneously distorts Kennecott's sales outside of California. These contentions ignore the fact that while *gross sales* are used to compute the sales factor, only *net income* is subject to the franchise tax. Since no net income is produced by the internal sales, it was not required that they be included in the computation. We think the above described methods used by the Board were fairly calculated to assign to California only that portion of the net income reasonably attributable to the business done in this state,[18] and conclude that the Board properly computed the payroll and sales factors.

Finally, we turn to Chase's argument that on remand, the court below abused its discretion in approving the Board's use of allegedly erroneous figures in making the required adjustments to the property, payroll and sales factors of the allocation formula to reflect the *Chase I* holding that the "other metals business" was not a part of the unitary business. We note that as one commentator indicated, Chase I did not explain how this was to be done, "but it would certainly involve methods which are equivalent to formulary apportionment, and which have the same inherent inaccuracy." (Boren, Separate Accounting In California and Uniformity in apportioning Corporate Income, 18 U.C.L.A.L.Rev. 478, at p. 532.)

The record indicates that in the initial *Chase I* assessment, the Board, on the basis of its determination that the "other metals" activities were part of the unitary business, included in the respective denominators of the property, payroll and sales factors, the part of Kennecott's property, payroll and sales attributable to the "other metals" activities.[19] After the remand, the Board first determined the

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18. As a result of this conclusion, it is not necessary for us to reach the constitutional arguments made by Chase (cf. *Montgomery Ward & Co. v. Franchise Tax Bd.,* 6 Cal.App.3d 149, 158, 85 Cal. Rptr. 890).

19. As all of these "other metals" activities occurred outside California, the numerator of each factor as originally computed has no components attributable to "other metals."

percentage relationship between the sales of other metals and total sales for each year; then it applied this percentage to the payroll and property factors and subtracted the resulting amounts from the total payroll and total property factors to obtain the final denominator[20] for each factor.

Chase objects primarily to the Board's use of the relative sales value in making these adjustments. Pursuant to this approach, the Board used the sales value of copper and the other metals in order to apportion the plants and payroll in computing these factors. Chase argues that the Board's method is contrary to the holding of *Chase I* indicating that the other metals are separate businesses from the unitary copper business and that its by-products accounting method as to the other metals calls for different results. However, as admitted by Chase, all of the other metals came from the same ore as the copper. The other metals are separated from the copper at various stages of the process.[21] Up to the point where the other metals are separated out, the same property and same payroll are involved in the process. Thus, it makes no sense for the purposes of the payroll and property factors to attribute 100 percent of the payroll and property only to the copper business or only to the

20. This is a general summary of the method used by the Board. The detailed calculations and figures are described in the stipulations of the parties on remand. The figures used in the Board's revised schedules were derived from the figures and tax returns at the first trial and from Kennecott's federal tax returns, which were introduced without objection as Exhibits B, C and D at the 1972 hearing of the second trial. The Board's revised schedules were a part of the Board's Exhibit A; Chase's objection to only the net income figures in Exhibit A was sustained; Exhibit A was marked but never admitted into evidence.

21. After the mined ore is concentrated, molybdenite is removed. During the ensuing smelting and refining stages, copper and the other metals are still together. Only in the final refining stage are all the gold, silver and other metals separated from the copper.

other metals business. The joint-products approach used by the Board was reasonable and in accord with the holding of *Chase I.*

Chase also argues that the Board should have apportioned the payroll and property, not on the basis of sales value, but on the basis of the weight of copper and the other metals. This contention, as the Board points out, fails to recognize that the factors chosen for the apportionment formula are based on their income-producing element (*Montgomery Ward & Co. v. Franchise Tax Bd.,* 6 Cal. App.3d 149, 159, 85 Cal.Rptr. 890; *John Deere Plow Co. v. Franchise Tax Bd.,* 38 Cal.2d 214, 224, 238 P.2d 569). The payroll factor also is to reflect the personal services of individuals in the earning of income (Wahrhaftig, Allocation Factors in Use in California, 12 Hast.L.J. 65, 73). Here, although Kennecott recovered about 16 pounds of copper per ton of ore, the sales price of the copper was about $.36 per avoirdupois (16 oz.) pound. Although only minute quantities of some of the other metals were recovered per ton, the most valuable of these other metals, silver and gold, were sold to the federal government at the fixed prices of $10.86 and $420 per troy (12 oz.) pound, respectively. The allocation by weight proposed by Kennecott would treat a 16 ounce avoirdupois pound of copper as being equally capable of producing income as a 12 ounce troy pound of gold. For this reason, the Board's use of sales value rather than weight to apportion the payroll and properties between copper and other metals was reasonable under the circumstances and not in conflict with the holding of *Chase I.* Chase has not explained how this particular practice has resulted in an unfair determination of its taxable California net income.

In conclusion, we can only reiterate that all authorities

recognize there is an inherent inaccuracy in any use of the unitary business allocation formulas. The Board's methods and calculations here in issue must be viewed within the context of these limitations. In view of the many complex computations and unprecedented recomputations required here after *Chase I*, we think the trial court properly concluded that the Board's methods were fair and within its statutory mandate.

Affirmed. Each party to bear its own costs on appeal.

KANE and ROUSE, JJ., concur.

Hearing denied; BIRD, C. J., did not participate.

Appendix E

FILED SEP 12 1977

Court of Appeal—First App. Dist.
CLIFFORD C. PORTER, Clerk

By .....
DEPUTY

In the Court of Appeal of the State of California
First Appellate District, Division Two

1 Civil No. 38789

Chase Brass and Copper Co., Incorporated,
Plaintiff, Respondent, and Appellant,

vs.

Franchise Tax Board of the State of California,
Defendant, Appellant, and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Chase Brass and Copper Co., Incorporated, the Plaintiff, Respondent, and Appellant above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Appeal of the State of California holding that the business of Chase Brass and Copper Co., Incorporated, is unitary with that of its parent, Kennecott Copper Corporation and with that of Kennecott Sales Corporation and Kennecott Wire and Cable Co., entered in this action on June 7, 1977 (Peti-

tion for Rehearing denied by the Court of Appeal on July 7, 1977; Petition for Hearing denied by the Supreme Court of California on August 11, 1977), affirming the remand judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.

This appeal is taken pursuant to 28 U.S.C. § 1257(2). Dated: September 8, 1977.

s/ VALENTINE BROOKES
Valentine Brookes

s/ LAWRENCE V. BROOKES
Lawrence V. Brookes VB

Counsel for Plaintiff,
Respondent and
Appellant

I hereby certify that on this 8th day of September, 1977, three copies of the Notice of Appeal to the Supreme Court of the United States were mailed, postage prepaid to:

Evelle J. Younger, Attorney General
Ernest P. Goodman, Assistant Attorney General
Timothy G. Laddish, Deputy Attorney General
State of California
350 McAllister Street
San Francisco, California 94102,

counsel for Defendant, Respondent and Appellant. I further certify that all parties required to be served have been served.

s/ VALENTINE BROOKES
Valentine Brookes

s/ LAWRENCE V. BROOKES
Lawrence V. Brookes VB

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Respondent and
Appellant

Appendix F

CONSTITUTIONAL PROVISIONS

The Commerce Clause (Art. I, § 8, cl. 3):

"The Congress shall have Power . . . to regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

The Due Process Clause (Amend. XIV, § 1):

"[N]or shall any State deprive any person of life, liberty, or property, without due process of law;"

STATUTES

California Revenue and Taxation Code:

25101. Basis of allocation. When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State. Income from business carried on partly within and partly without this State shall be allocated in such a manner as is fairly calculated to apportion such income among the states or countries in which such business is conducted. Income attributable to isolated or occasional transactions in states or countries in which the taxpayer is not doing business shall be allocated to the state in which the taxpayer has its principal place of business or commercial domicile.

If the Franchise Tax Board reallocates net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to him the basis upon which its reallocation has been made.

25105. Ownership or control. Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purposes of this article.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303c.)

Appendix G

Selected Portions of the Stipulation of Facts

IT IS HEREBY STIPULATED by and between the parties hereto by their respective counsel that for the purpose of trial of the above entitled case the facts hereinafter stipulated are true and correct and may be treated by this court as facts proven in open court.

• • • • •

2. The statements set forth below are applicable to the calendar years 1954, 1955, and 1956, unless otherwise specifically indicated.

3. (a) Kennecott is a corporation of the State of New York, with its main office in the City of New York. It is qualified to do and does business in many states of the United States, but it was neither qualified to nor did it do business in the State of California during the years in question. Kennecott is a publicly held corporation, its stock being listed on all major exchanges.

(b) Chase is a Connecticut corporation organized under the laws of the State of Connecticut in the year 1909, with its principal office and place of business in Waterbury, Connecticut. It has manufacturing establishments located in the State of Connecticut and in the State of Ohio. It is qualified to do business and is doing business in more than twenty-five states of the United States, including California. Ownership of all the capital stock of Chase was purchased by Kennecott from outsiders in the year 1929, and since then all of its capital stock has been wholly owned by Kennecott.

(c) Kennecott Wire, during the period in question, was a corporation of the State of Rhode Island. All its outstanding capital stock was purchased from outsiders by Kennecott in 1935 and has been owned by Kennecott at

all times since; after that stock acquisition, its name was changed from American Electrical Works to its present name.

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(e) Kennecott Sales is a corporation of the State of New York. It is not qualified to do business in California. The stock of Kennecott Sales is wholly owned by Kennecott.

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4. (a) The principal business activity of Kennecott was and is the production of copper and other metals present in copper-bearing ore. This involves the mining, beneficiation, smelting and electrolytic and fire refining of copper-bearing ores and the selling of the metals and metallic compounds produced from the ores.

• • • • •

Kennecott was the largest copper producer, the second largest gold producer, the fourth largest silver producer and the second largest molybdenite producer in the United States in these years. Kennecott does not engage in manufacturing or fabrication in any way, other than such fabrication or manufacturing as it may do in its own shops for use in its various divisions, but this fabrication or manufacturing is not of products for sale.

Kennecott owns and operates as its western divisions, four mining properties in the United States, one being located in each of the States of Utah, Nevada, Arizona, and New Mexico. The products of Kennecott's four western divisions consist primarily of copper, gold, silver, molybdenite, and minor amounts of other metals, including selenium, platinum and palladium.

The copper as sold by Kennecott is in the usual commercial forms, such as slabs, cakes, ingots, ingot bars, cathodes, billets, and wire bars and copper precipitates. As

such, the copper is fungible and is not in the form of commercial end use products.

Some of the copper is sold as blister copper, in which form it is used in the preparation of fungicides and chemicals, and in some cases it is further refined by the purchaser. Precipitate copper, which is obtained by leaching the waste piles, is sold in minor quantities for making pigments and for metallic power purposes, and the balance is not sold as precipitate but is fed into the smelter with other copper concentrates.

Some of Kennecott's copper (produced only at the Chino, New Mexico, Mines Division), is sold as fire-refined copper and is used primarily for non-electrical purposes and for producing certain types of brass and bronze but is not customarily further refined.

The balance of the copper, which is the major portion, is sold after being electrolytically refined and made usable for fabrication into brass mill or into wire mill products.

(b) Chase is primarily engaged in the manufacture and sale of brass, copper rod, sheet, wire, and tube, such products usually being designated in the trade as "brass mill products." Chase owns no mines, and does no mining, concentrating, smelting or refining of metals or ores. Chase is not engaged in the business of buying and selling virgin copper. The copper received by it, with minor exceptions, is changed in form by fabrication or by melting and then fabricating or by melting and combining with other metals to form alloys and then fabricating. Chase's sales are almost wholly domestic. In a typical year it will sell products to more than 18,000 accounts.

(c) Kennecott Wire's principal business during the years under consideration was the fabrication and sale of copper rod, wire and cable for electrical transmission purposes, such items being commonly designated and referred to as "wire mill products." In addition, it fabricated some nonferrous wire for the screencloth business, and also some aluminum wire and cable. Kennecott Wire owns no mines, and does no mining, concentrating, smelting or refining of metals or ores.

* * * * *

(e) The sole business activity of Kennecott Sales is the sale of all the metals produced by Kennecott and Braden to customers in the United States and abroad, except (a) gold and silver, which are sold directly by Kennecott; and except (b) certain copper produced by Braden and sold for use in Chile under governmental regulation. * * *

* * * * *

5. (a) In the years involved Kennecott was managed by a Board of Directors consisting of fifteen members, one of whom was an officer of Kennecott, except that in a portion of 1954 two directors were officers of Kennecott. None of the directors were residents of California. The Board of Directors of Kennecott did not handle the day to day operations of Kennecott's various divisions or subsidiaries. Rather, day to day operations of Kennecott were the concern of its executives and were handled by the general managers of the divisions. The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries

reported to the President of Kennecott with respect to major policy matters.

(b) The Board of Directors of Chase consisted of eight members. They are elected by Kennecott as the sole stockholder of Chase. Save for three officers of Kennecott, the directors of Chase, during the period in question, were all officers of Chase and residents of Connecticut. However, none of the three Kennecott officers attended a meeting of the Chase Board during the period in question. No employee or officer of Kennecott was an officer of Chase during the period in question or since.

During the three years in question, the President of Chase was Richard C. Diehl, whose office was at the main office of Chase in Waterbury, Connecticut, and from which office he directed the affairs of Chase. His time and attention were given to Chase; he was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He had a complete staff and line organization under his direction which carried out the fabricating, pricing, selling, warehousing, purchasing, record keeping, advertising, employee relations, and all the other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale.

(c) The members of Kennecott Wire's Board of Directors were elected by Kennecott as sole stockholder. The Board consisted of either eight or nine members, of which at times five and at times four were officers of Kennecott. The quorum of the Board was three. No meeting was held in 1954, 1955 or 1956 at which an officer of Kennecott was present except for one emergency meeting held on December 28, 1955, when the President had suffered a cerebral hemorrhage and no quorum was available without Kennecott officers; the only business transacted at the meeting

was a change in signatures on a bank account so that funds could be withdrawn during the President's incapacity. No employee or officer of Kennecott was an officer of Kennecott Wire during the period in question, or has been since. During the period in question, the President of Kennecott Wire was Alan F. Sheldon, whose office was at the headquarters of Kennecott Wire in Phillipsdale, Rhode Island. His time and attention were given to Kennecott Wire and he was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He also had a complete staff and line organization, which, under his direction, carried out the fabricating, pricing, selling (except such as was done by Chase under the arrangement described in paragraph 7) purchasing, record keeping, employee relations, and all other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale.

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6. The manner in which Chase conducted its business in the State of California has not changed substantially in all of the years that it has been qualified to do business in the State except for the sale of Kennecott Wire Products referred to in Paragraph 7. It did not act as an agent or representative of Kennecott or sell or otherwise dispose of any property owned by Kennecott. In general, its business dealings with Kennecott were confined to the purchase from Kennecott of virgin copper and the sale to Kennecott of relatively small amounts of merchandise as produced by it. Its purchases from Kennecott are effected from its main office in Waterbury, Connecticut. All of Chase's shipments into the State of California are in the form of products manufactured from copper or other metals or combinations thereof.

7. Until July 1, 1944, Kennecott Wire sold its products either directly through its representatives located in states in the Middle West or the Northeast or, in some cases, through distributors. By 1944 it had become apparent that Kennecott Wire could not continue operations as in the past, because better outlets and warehouse stocks of certain of its products were needed at convenient locations. As a result of studies which were made as to what should best be done, on July 1, 1944, Kennecott Wire entered into an agreement with Chase whereby Chase took over the sales, through its various sales offices and warehouses throughout the United States, of the major part of the products of Kennecott Wire. Certain high volume accounts which could be supplied by carload lot shipments from the factory in the Northeast, were retained by Kennecott Wire and sold directly. Under this arrangement, Chase purchased stocks of products from Kennecott Wire, placed them in various of its warehouses, and then resold them in the areas covered by such warehouses. Additionally, Chase salesmen called on prospective wire and cable customers whether or not there was stock in the warehouses to which such salesmen were assigned to secure orders for products of types produced by Kennecott Wire. These orders were then transmitted to Kennecott Wire at its home office, the stock was produced by Kennecott Wire and billed and shipped in the name of Chase, with Chase receiving a discount on the products sold. Further, certain of Kennecott Wire's employees did promote sales of the products it produced, either alone or in conjunction with Chase's sales activities.

Prior to the Kennecott Wire—Chase agreement, Kennecott Wire did not have extensive warehousing facilities. After the agreement, it did not maintain any stocks of

wire and cable in the Chase warehouses. When there was a stock of wire or cable in the Chase warehouses, it was the property of Chase, not Kennecott Wire. Under the arrangement described above Chase did sell in the years in question Kennecott Wire products to customers in California.

8. Kennecott has no employees in California. Kennecott employees did not supervise Chase employees in California or elsewhere.

9. In the years in question, 1954, 1955 and 1956, no representative of Kennecott Sales was in the State of California for the purpose of selling, attempting to sell, or soliciting sales of metals for which it is the agent, nor for the purpose of missionary work of any type, nor was any representative of Kennecott in California for such purpose or purposes. The shipments into California were the result of negotiations outside California.

10. During the period in question, Kennecott shipped 14,032 tons of copper into California. Nearly all of this amount was bought by General Cable, American Smelting and Refining Company, and Revere Copper & Brass Company on orders negotiated with Kennecott Sales and placed by those companies through their New York offices. None of these corporations is owned or controlled by or affiliated with Kennecott or any corporation owned or controlled by it. There was no solicitation or direct dealing with the branches of these companies in the State of California. Twelve thousand tons of Braden copper were shipped to the General Services Administration of the United States Government on a contract made in Washington, D.C. for stockpiling in California.

In 1956 Kennecott also sold to the Mountain Copper Company Limited at Martinez in California twelve drums

of copper precipitate totaling 3,035 pounds for what was understood to be an experimental order, and 30 tons of copper to the Chicago plant of H. Kramer & Company of El Segundo, California. The only other shipments into the State of California in the years in question were of selenium, sold to the International Rectifier Company at El Segundo, California, and to Owens-Illinois Glass Company at Los Angeles and Oakland, California. In 1954, Kennecott sold International 3,350 pounds of selenium for $24,300; in 1955, 5,000 pounds for $59,400; and in 1956, 6,050 pounds for $105,400. On orders received from the main office of Owens-Illinois at Toledo, Ohio, Kennecott shipped to that company's plants in California 2,350 pounds of selenium in 1954 and 700 pounds in 1955. These sales were not solicited or obtained by Kennecott in California. None of the purchasing corporations is owned or controlled by or affiliated with Kennecott or by any corporation owned or controlled by or affiliated with it.

11. (a) The property of Chase in the State of California included inventories of the products which it was engaged in selling, located in warehouses either owned or leased by it in the City of South San Francisco and in the City of Los Angeles. The balance of Chase's California property consisted of real estate, office furniture, fixtures, machinery and equipment. It maintained a sales office at the warehouses in South San Francisco and in Los Angeles. It had no more than fifty-one employees either living in the State of California or representing it in the State of California.

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Throughout the United States, Chase had 7,617 employees on December 31, 1954, 8,197 employees on December 31, 1955 and 6,731 employees on December 31, 1956. In California it had 44 employees on December 31, 1954, 43 employees on December 31, 1955, and 50 employees on December 31, 1956.

(b) Of Chase's total sales in the years in question approximately 3.8% in 1954, 4.5% in 1955 and 4.9% in 1956 were to customers in California. Of Chase's sales of wire mill products, approximately 4.1% in 1954, 2.5% in 1955 and 4.5% in 1956 were to customers in California.

The amount of Chase's sales to California customers during the years here involved were:

1954	1955	1956
$6,506,833.00	$9,589,614.00	$10,422,917.00

12. (a) The amount of virgin copper purchased by Chase and Kennecott Wire from Kennecott is determined by the needs of Chase and Kennecott Wire; the amount of copper to be required for operations for a given month is estimated by Chase and Kennecott Wire, and Chase, which buys scrap, then subtracts from this amount the tonnage of copper content of scrap to be purchased from its own customers or from other sources such as scrap dealers. The balance usually represents the amount purchased from Kennecott.

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14. Kennecott, through Kennecott Sales, sells to Chase approximately 20% of its total production of copper and sells to Kennecott Wire approximately 4%, leaving about 76% which it sells to its other customers.

15. Those products produced by Chase and Kennecott Wire which were purchased by Kennecott were purchased at the going price which was the same price as was charged any other customer. The amount of sales by Chase and Kennecott Wire to Kennecott and its affiliates (exclusive

of the sales by Kennecott Wire to Chase which were made for resale as described in paragraph 7) for the years here involved were:

1954	1955	1956
$329,982.00	$301,285.00	$451,039.00

16. In order that Kennecott and its subsidiaries might operate at the lowest possible cost, and in some instances, to assure results compatible to all the companies in which Kennecott owned stock, certain matters were handled either jointly or on a uniform basis, and they were as follows:

(i) Salaries of more than $15,000 for employees of Chase and of Kennecott Wire were submitted to Kennecott's Salary Committee.

(ii) There was some purchasing of supplies on contracts negotiated by Kennecott, but this was minor. Ordinarily, Chase and Kennecott Wire purchased from outside sources of each's own selection.

(iii) There were minor charges between the companies, but these charges were in no case greater than would have been charged by or to a company not affiliated with Kennecott.

(iv) There were some instances in which insurance coverage could be combined for two or more companies, with a more advantageous rate, or better coverage, or a better spread of risk. In one instance the cost of separate coverage would have been prohibitive. The charges in every case were prorated on an allocable basis. Kennecott could have secured the coverage desired without covering the subsidiaries. There was no intercompany coverage on basic industrial policies such as Fire, Fire U. & O., Workmen's Compensation, Public Liability, Automobile Liability and

Fire, Sickness and Accident, Hospitalization and Surgical and certain types of bonds.

(v) There was a common Retirement Plan for Salaried Employees, which was administered on an overall basis by Kennecott in New York. The reason for having one Retirement Plan is that, at the time it was installed, it appeared more economical. It also assured salaried employees in each company the same treatment as those in the other companies.

The Pension Plans for Hourly Employees, which covered hourly employees, were not only not uniform but also they did not cross the border between corporations, i.e., no Kennecott hourly employee was covered by a Chase or Kennecott Wire Plan, nor, conversely, were the employees of Chase or Kennecott Wire covered by the Kennecott Plans, nor did Chase and Kennecott Wire Plans cover employees of the other. Each corporation had a separate Plan or Plans, and each bore its own cost of administration.

17. There has been * * * very little interchange [of employees] between Kennecott and the fabricating companies, Chase and Kennecott Wire; not more than six salaried employees have been transferred to or from the fabricating companies and Kennecott in the last twenty years.

* * * * *

Employees have moved from the employment of Chase to Kennecott Wire and From Kennecott Wire to Chase. The former President of Kennecott Wire came from Chase, as did the General Sales Manager and an engineer. Officers and employees have also come from outside employment; viz., Charles Cox, president of Kennecott, from U.S. Steel Corp., Richard Diehl, president of Chase, from Wheeling Steel Corp., and Glenn Bakken, executive vice president of Chase, from Reynolds Metals Corp. When Chase entered

into the arrangement to sell most of the products of Kennecott Wire, it employed some salesmen and sales engineers previously employed by Kennecott Wire.

If there were hourly employees who transferred from one company to another, the transfers were made on their own account and not on company request.

18. Chase received loans from Kennecott totaling $10,000,000.00 to rehabilitate the Waterbury mill plant which was severely damaged in the flood disaster of 1955. On these loans, Chase was charged interest at the rate of 3½ per cent, which was equal to the prime bank rate of interest. All funds borrowed plus interest were repaid within four years.

19.(a) Chase handled its own personnel policy and industrial relations and did its own negotiating in labor matters. The labor advisor for Kennecott sometimes exchanged information with Chase relative to preparation of union contracts and rates of pay for various skills.

(b) Chase maintained its own administrative offices and kept its own separate books of account. It had its own accounting and internal audit staff, and handled its own tax matters with the exceptions noted below. In addition to its own manufacturing operations it had its own credit, purchasing and traffic departments, its own sales force, and its own research department and laboratory. These were staffed with its own personnel. Kennecott Wire prepared and sent Chase invoices to Chase customers for many sales by Chase of Kennecott Wire's products. Kennecott and Chase both made contributions to the Copper and Brass Research Association.

(c) Chase maintained its own internal advertising department and staff which worked independently in the preparation and publication of material which advertised

Chase products. Chase developed its own advertising program and budget, which was not submitted to Kennecott for advance approval. When Chase placed advertising through an advertising agency, it used the same agency that Kennecott used. The name and trademark of Chase is predominant in its advertisements in trade journals, magazines and newspapers. These advertisements often contain as part of the Chase trademark the statement that Chase is a subsidiary of Kennecott Copper. Kennecott's advertising often stressed the importance of "adequate wiring."

(d) In addition to its own manufacturing operations Kennecott Wire had its own personnel, purchasing, traffic and research departments which were staffed with its own personnel.

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(f) Kennecott and all the subsidiaries used the same public accounting firm. Consolidated accounting and the preparation of certain tax reports were done by Kennecott in New York. During the years in question, Chase did the accounting and reviewed the taxes for Kennecott Wire for a fee. Kennecott furnished Braden whatever accounting, administrative and legal services Braden had a need for in the United States, and for this service Kennecott charged Braden a fee. Kennecott furnished Bear Creek and Kennecott Sales accounting, administrative and legal services for a fee.

(g) Chase had its own legal staff and on occasion employed its own outside counsel. Kennecott furnished Kennecott Wire with legal services for a fee. Kennecott employees handled the preparation and presentation of the protests of Chase and Bear Creek before the Franchise Tax Board in these proceedings.

20. On occasion, there have been loans of specialized personnel from Chase to Kennecott and from Kennecott to Chase, but these occasions have been infrequent. Also, Kennecott had two employees working at Chase for a period of approximately two years on a joint research program exploring the question of the compacting of titanium powder, a product of Quebec Iron & Titanium Corp.

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21.(i) Kennecott sold its copper to all its customers, including Chase and Kennecott Wire, at what is called the "producers price." Kennecott did not charge Chase or Kennecott Wire prices for copper that differed from prices it charged its other customers. The "producers price" is the price, published in trade journals, which is charged for domestic copper by the three giants of the copper industry: Kennecott, Anaconda, and Phelps Dodge. During periods when the copper fabricators are demanding more copper than is being produced by Kennecott, Kennecott would sell to its customers, including Chase and Kennecott Wire, on an allocation basis. The allocation procedure, which was normally based on amount of purchases during a particular test period, was determined by the management of Kennecott and Kennecott Sales, and was not used to give Kennecott subsidiaries special purchasing preference over Kennecott's other customers.

Kennecott and Braden deliver substantial amounts of metal annually to a relatively small number of customers.

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31. No consolidated federal or state tax returns were filed.

35. For the years 1954, 1955 and 1956, Kennecott Wire paid to the State of Rhode Island tax on its entire corporate net income as net income is defined by Rhode Island law, and Rhode Island did not allocate any part of said Kennecott Wire net income to other states.

For the years 1954, 1955 and 1956, Kennecott Sales paid to the State of New York tax on its entire corporate net income as net income is defined by New York law, and New York did not allocate any part of said Kennecott Sales net income to other states.

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Appendix H

CHASE BRASS & COPPER CO.

Computation of Revised Liability for 1954-6

	1954	1955	1956
STEP ONE: DETERMINATION OF APPORTIONABLE INCOME			
Total Unitary Income per Notice of Action 6/14/63	$97,595,277.28	$192,379,361.64	$214,740,429.95
Eliminate Subsidiaries from Combined Report:			
Braden Copper Company	(6,523,767.89)	(56,919,517.30)	(62,821,397.28)
Bear Creek Mining	(55,487.57)	(88,951.69)	(51,061.32)
Eliminate Net Profit from Metals other than Copper —per Finding 2(h) of Judge Molkenbuhr	(30,321,857.61)	(32,743,300.57)	(34,835,182.66)
Unitary Income	$60,694,164.21	$102,627,592.08	$117,032,788.69
STEP TWO: DETERMINATION OF ALLOCATION PERCENTAGE			
Revised Property Factor —Per Sch. IIa	.51572	.57281	.69735
Revised Payroll Factor —Per Sch. IIb	.26792	.25289	.24808
Revised Sales Factor —Per Sch. IIc	1.98839	2.29701	2.36707
Average Allocation Percentage	.92401	1.04090	1.10416
STEP THREE: DETERMINATION OF TAX AND AMOUNT OF REFUND			
Net Income Allocated to California	$ 560,820.14	$ 1,068,250.61	$ 1,292,229.24
Tax at 4%	22,432.81	42,730.02	51,689.17
Tax Paid	28,952.22	65,876.85	79,601.70
Tax to be Refunded	6,519.41	23,146.83	27,912.53

Appendix I

It may be that Chase could have borrowed the money from lending institutions, but the fact remains that it could turn readily to its parent for help. It must have been deemed advantageous to the over-all management to have handled the transaction in this way, otherwise a separate arrangement would have been made. (App. 18.)

It is top level management which is credited (or, in case of failure or indifferent results, debited) with the effects of corporate enterprises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource. The stipulation of facts reads: "The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries (etc.)." (App. 18.)

To have a buyer of a substantial portion of the parent's production throughout the years must be assumed to be an advantage. (App. 21.)

The percentage which governed the amount of copper allocable to Chase was built over the years. (App. 21.)

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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Court of Appeal for the following reason:

This case does not present a substantial federal question.

INTRODUCTORY STATEMENT AND SUMMARY OF ARGUMENT

Appellant Chase Brass and Copper Co. (hereinafter referred to as "Chase") has brought this matter to this Court before. In 1970, after analyzing the Stipulation of

Facts, the numerous exhibits admitted into evidence and the testimony of the witnesses offered by appellant, the California Court of Appeal concluded that the undisputed facts demonstrated as a matter of law that the activities of Kennecott Copper Corporation (hereinafter referred to as "Kennecott") and three of its wholly-owned subsidiaries (Chase, Kennecott Wire and Kennecott Sales) were dependent upon each other to the extent that it was proper to treat the operations of the group as a "unitary" business.[1] Accordingly, since Chase was doing business in California, the Court held that for purposes of the California franchise tax measured by net income it was proper to compute the amount of income attributable to Chase's California activities by applying a fair apportionment formula to the total unitary net income of the business of which Chase was a part. *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 87 Cal. Rptr. 239. That decision shall hereinafter be referred to as *Chase I;* said decision is presented in full as Appendix B to Chase's jurisdictional statement, and citations herein to that decision shall be to the pages of said appendix. (The jurisdictional statement shall be cited herein as "J.S."; pages in the jurisdictional statement's appendices shall be cited herein as "J.S. App.").

After unsuccessfully seeking a hearing in the California Supreme Court, Chase appealed *Chase I* to this Court, claiming that the decision was unconstitutional. On December 21, 1970, this Court ordered as follows:

> "Appeal dismissed for want of jurisdiction. Treating the papers whereon the appeal was taken as a petition for writ of certiorari, certiorari denied." *Chase Brass & Copper Co. v. Franchise Tax Board of California* (1970) 400 U.S. 961.[2]

1. The Court held that two other wholly-owned subsidiaries of Kennecott (Bear Creek and Braden) were not part of the unitary business.

Upon remand, the California Superior Court decided most of the issues contrary to Chase's position. The trial court's findings of fact, conclusions of law and judgment are contained as Appendix C to the jurisdictional statement (J.S. App. 24-27). That court's decision on remand was affirmed on cross-appeals in the California Court of Appeal. *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1977) 70 Cal.App.3d 457, *modified,* 71 Cal.App.3d 471c, 138 Cal. Rptr. 901. This second appellate decision shall be referred to herein as *"Chase II";* citation thereto shall be to the opinion as included as Appendix D to the jurisdictional statement. Cross-petitions for hearing in the California Supreme Court were denied, and Chase has again appealed the matter to this Court, raising many of the same grounds Chase argued to this Court in 1970.

In our Argument, which follows a brief statement relating to the facts, we shall demonstrate that there is no merit to appellant's contentions and that the decision of the California Court of Appeal is in accord with established decisions of this Court. The following is offered as a fair summary of the Argument.

2. From the first sentence Chase argues (J.S. 4) that this Court's dismissal was not on the merits but was a result of the state decision, which ordered a remand for further determinations, not being final. However, from the second sentence is it reasonable to conclude that the Court felt that the judgment was "final" and ripe for review, but that its jurisdiction to review came by way of certiorari under 28 U.S.C. § 1257(3) rather than by way of appeal under 28 U.S.C. § 1257(2). It would be reasonable to conclude that the state court judgment did not uphold the validity of a state statute (a prerequisite to jurisdiction to review the case by appeal under section 1257(2)) but simply rejected the taxpayer's claim that its federal rights prevented the application of the statute to it (which would be reviewable only by certiorari under section 1257(3)).

I. In order that this Court can view this case in context, we will first set forth a brief summary of the theory underlying California's approach to corporate income taxation. In that regard, we shall point out that California still follows the "unitary business" concept approved by this Court in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. In applying the unitary business concept, California stresses substance over form. Accordingly, the unitary business rule is applied regardless of whether the related activities are carried on within the framework of a single corporate entity, as in *Butler Bros.*, or by a parent and a group of wholly-owned subsidiaries, as in *John Deere Plow Co. v. Franchise Tax Bd.* (1951) 38 Cal.2d 214, 238 P.2d 569, *appeal dismissed* 343 U.S. 939.

II. Next, we shall apply the theory to the undisputed facts in this case and show that, beyond any doubt, the activities of the four corporations now involved here were interrelated to the extent that it was proper to treat the entire group as a unitary business. Essentially, Kennecott and its subsidiaries are engaged in an integrated copper business, with activities ranging from mining the copper ore down to selling fabricated copper products to consumers. Kennecott mines, concentrates, smelts and refines virgin copper. Chase and Kennecott Wire are copper fabricators. They are dependent upon Kennecott for their basic raw material, refined copper. Kennecott Sales is the intermediary which handles the sales of refined copper. Thus, the corporations present the classic example of a vertically structured business. There existed between the corporations the degree of intercompany contacts that are normally expected in a vertically structured business of this type.

III. Our third section merely points out the application by California of the standard three-factor formula of property, payroll and sales to the unitary business. Chase's challenges to this application are answered in later sections.

IV. In the fourth section of our Argument, we shall point out the errors in Chase's contentions. In its Jurisdictional Statement, appellant makes numerous assertions to support its position. The arguments are untitled and there are no section headings. In many instances, the contentions overlap and it is difficult to tell exactly what Chase's legal position is, except that it does not like its income computed by the combined unitary method. We shall attempt to pick out the factors relied upon most heavily by Chase and demonstrate why the arguments based thereon are unmeritorious.

A. Chase bases much of its appeal on a completely baseless argument that California's holding that a unitary business existed was based solely on Kennecott's ownership of the stock of its subsidiaries. The ridiculous nature of this argument will be discussed.

B. Chase stresses the fact that the activities of Chase, Kennecott Wire and Kennecott Sales were carried on by wholly-owned subsidiaries of Kennecott rather than by divisions of Kennecott itself. We do not believe that it is unconstitutional to look to the substance of the business, rather than be controlled by the form in which the business is carried on. To accept appellant's apparent position in that regard would be to write a blueprint for tax avoidance whereby even the most unitary of businesses could lower their State taxes simply by changing the form in which they conduct business. For example, the operations of General Motors Corporation unquestionably present a uni-

tary business situation. See *General Motors Corp. v. District of Columbia* (1965) 380 U.S. 553. Yet, under appellant's approach, General Motors could create "separate businesses" by separately incorporating individual portions of its activities.

C. Chase's claims that California is taxing Kennecott's property and income ignores the function of the factor apportionment of net income of a unitary business. To the contrary, application of the factors to the net income of the entire unitary business merely determines the net income of the *California* business, which was carried on entirely by Chase.

D. Chase confuses combined reporting of all segments of a unitary business with the consolidation procedures which are necessitated when two or more corporations have artificially shifted income between themselves for tax purposes. Such intentional shifting is not a prerequisite to a determination that a unitary business exists.

E. Chase's contention that the unitary rule cannot be followed in franchise tax cases is answered by reference to common sense and to this Court's action in *John Deere Plow Co. v. Franchise Tax Board* (1951) 38 Cal.2d 214, 238 P.2d 569, *appeal dismissed*, 343 U.S. 939 (1952).

F. Chase doggedly attempts to use separate accounting to impeach California's use of the standard three-factor formula in determining the true California net income. These attempts are made in spite of a clear holding by this Court contrary to Chase's position in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. Chase's heavy reliance on an ad valorem property tax case (*Norfolk & Western Ry. v. Missouri Tax Comm.* (1968) 390 U.S. 317) is misplaced, as there is a great difference between determining what

items of property are within a state at a particular time and determining what portion of a multi-state unitary business' annual net income should be attributed to a state. For one thing, the "enhancement" theory applicable in property tax cases is not applicable here. Chase's reliance upon *Hans Rees' Sons v. No. Carolina* (1931) 283 U.S. 123, is also misplaced, as such reliance does not take into account the effect of this Court's later decision in the *Butler Bros.* case. Finally, Chase's separate accounting use of the 1955 flood loss is shown to be an example of how Chase ignores the unitary concept: the California result acknowledges that said flood loss was indeed a real loss, and said loss was fully reflected in the determination of the unitary net income for that year.

G. Based solely on the fact that California has not specifically quoted one segment of one of this Court's decisions, Chase makes the surprising (and ludicrous) claim that California will not permit any constitutional attack on results reached in any case by application of formulary apportionment of unitary net income. We shall show that California has always recognized this Court's rule that clear and cogent evidence (which does not include separate accounting) will always be admitted in considering any such challenge.

H. Chase has pointed to no clear and cogent evidence to support the challenges it raises in its jurisdictional statement to the computation below of the property and payroll factors.

I. Chase's challenge on multiple taxation grounds to the California application of the standard three-factor formula is contrary to Chase's own 1972 recognition that Utah's deviation from the standard approach (in *Kennecott Copper Corp., et al. v. State Tax Commission of Utah* (1972) 27 Utah 2d 119, 493 P.2d 632, *appeal dismissed*,

409 U.S. 973) would have no effect on the validity of other states' using that standard approach. We shall show that Chase was right on this point in 1972. Also, the tax years involved in the present case are considerably earlier than the Utah enactment giving rise to the Utah case; thus there is no way that the Utah case could result in multiple taxation with regard to California liabilities for the years here in issue.

V. Finally, we refer to the arguments of the amici curiae, which are sufficiently answered in the rest of this motion to dismiss or affirm.

STATEMENT REGARDING THE FACTS

Before beginning our argument, it is appropriate to comment upon appellant's statement of the facts. The factual record in this case is voluminous. It consists of a lengthy stipulation of facts, a thick stack of exhibits and testimony of witnesses offered by appellant. Although the record is large, none of the facts are disputed. Since the facts are undisputed, the California Court of Appeal was presented solely with a question of law. Some of the numerous cases which so hold are cited in the *Chase* I decision in this case. Accordingly, the so-called "findings" of the trial court which are merely mislabeled conclusions of law are not binding on appeal. J.S. App. 15-16. Yet, it is these conclusionary statements of the trial judge upon which appellant relies most heavily. For example, on page 11, appellant quotes in full the statement of the trial judge to the effect that the apportionment formula operates to assign Kennecott's income to Chase. While treating such erroneous legal conclusions as undisputed facts tends to make appellant's job easier, it indicates that this Court should be careful not to accept as true appellant's conclusionary statements regarding the factual relationship that existed between Kennecott and its subsidiaries.

Chase's jurisdictional statement stresses those facts which tend to support the legal conclusion it seeks and ignores many undisputed facts which point the other way. Thus, appellant treats the operations of Kennecott's fabricating subsidiaries (including Chase) as in no way benefiting Kennecott's income producing activities. But appellant fails to tell this Court that it is an undisputed fact that in 1958 the vice-president of Kennecott recommended that the Board of Directors of Kennecott approve the acquisition of yet another fabricator because, in the language of Kennecott's executive:

> ". . . the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper . . ." (Stipulation Exhibit F)

See *United States v. Kennecott Copper Corporation* (1964) 231 F.Supp. 95, *affirmed* 381 U.S. 414, wherein the acquisition of the fabricator was held to be a violation of the anti-trust laws. Again, appellant would have this Court believe that Kennecott treated its fabricating subsidiaries the same as it treated independent fabricators. But when Chase in its argument quotes from the stipulation regarding the lines of authority and responsibility between the corporations, Chase omits the fact that "[t]he executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." J.S. App. 63-64. Chase also fails to state such facts as that the undisputed evidence shows that the president of Kennecott had a special assistant whose job was to assist the subsidiary companies with their engineering problems. (Stipulation Exhibit B, p. 20.)

We shall demonstrate that the facts actually before the California Court of Appeal support the Court's legal conclusions.

ARGUMENT

1. In Computing Income from California Sources, California Follows the "Unitary Business" Concept.

There is no national law which dictates the precise manner in which the states must allocate income for tax purposes. In our federal system, each state is allowed, subject to limitations imposed by the Constitution and the Congress in exercise of its powers, to adopt that method of computing income taxable in the state which best suits its particular needs. Because of the wide diversity of economic, political and business conditions that exist throughout our nation, it is no wonder that there is no uniform approach to the taxation of income of corporations that do business in more than one state.[3] We believe that the California approach is the most logical. However, so that this Court can view in context the California method here challenged by appellant, it is appropriate to very briefly outline the various alternatives.

Essentially, there are two different accounting methods that can be used to determine the amount of operating income attributable to a corporation's activities in the state, namely, separate accounting and formula apportionment. Under the separate accounting method, consideration is given only to the gross income and expense items directly related to instate activities.[4] Under this approach, a corpo-

3. The various methods of allocation and apportionment are described and discussed in detail in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 88 Cong., 2d Sess., H.R. No. 1480, June 5, 1964, Vol. 1, Chap. 7, on "Division of Income," at 155-249. Hereinafter, this report will be referred to as the Willis Subcommittee Report.

4. Separate accounting also occurs when net income is separately computed for only a portion of a unitary business, even though that portion encompasses business done in several states. *RKO Teleradio Pictures, Inc. v. Franchise Tax Board* (1966) 246 Cal.App.2d 812, 816-18, 55 Cal. Rptr. 299, 302-04.

ration could have net income in one state and losses in other states. Under the formula apportionment method, the net income of the entire operation is apportioned by formula between the various states in which the business is conducted. While there is no specific apportionment method required to be used by all states, the formula used most frequently is the three-factor formula of property, payroll and sales.

As indicated in the Willis Subcommittee Report, some states have a statutory preference for the separate accounting method whereas other states require the formula to be used in all cases. California does not fall into either of those extremes. California follows what has sometimes been referred to as the "unitary business" rule, whereby the formula apportionment method is applied only to "unitary" businesses. Accordingly, if the activities of the taxpayer in the state are non-unitary in character, then the amount of income attributable to those activities is determined by the separate accounting method. On the other hand, if the California activities are just part of a unitary business conducted both within and without California, the amount of income attributable to the California portion of the business is determined by the formula apportionment method. This Court expressly upheld the California method in *Butler Bros. v. McColgan* (1942) 315 U.S. 501.[5]

5. The rule has been applied consistently by the California courts under the statutes in effect during the years at issue here, regardless of whether the effect is to raise the amount of income attributable to California sources, as in *Butler Bros.*, or to lower the amount of income attributable to California sources, as in *Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal. 2d 406, 34 Cal. Rptr. 545, 386 P.2d 33, and *Honolulu Oil Corp. v. Franchise Tax Bd.* (1963) 60 Cal. 2d 417, 34 Cal. Rptr. 552, 386 P.2d 40.

Determining the scope or boundaries of the unitary business to which the formula is to be applied is not always easy and is a problem to which not all states have given the same solution. Not all business operations, particularly in this age of mergers and acquisitions, are as straightforward as in the *Butler Bros.* case. In *Butler Bros.,* the operations there held to be unitary were all conducted within the framework of a single corporate entity. Moreover, that corporate entity conducted no business operations in addition to those considered in the case. There are literally thousands of situations, however, where the boundaries of the unitary business and the corporate entity are not coterminous. There are numerous conglomerates that operate several distinct businesses within one corporate entity. On the other hand, there are numerous examples of a single business operation conducted by a group of affiliated corporations.

There are those states that, rather than attempting to solve the problem, simply let form control. Thus, all the income of a single corporation must be apportioned by a single apportionment formula, regardless of how unrelated the activities of the various corporate divisions might be. On the other hand, the combined apportionment method is never used, regardless of how dependent the corporation's activities are with those of affiliated corporations.

Again, California does not take this simple, but extreme, approach. California believes that, in conformity with the decision of this Court in *Butler Bros. v. McColgan, supra,* it is the income of a unitary business which should be apportioned by formula, regardless of the form in which that business is conducted. For example, assume a conglomerate had one division that produced and distributed motion pictures, another division which manufactured and sold

pharmaceutical products and yet another division which conducted aerospace research for the federal government. California would treat each division as a separate business and apportion the income of each business between the states in which such business was conducted. Likewise, if a parent corporation and its subsidiaries were engaged in a single unitary business, California would compute the amount of income attributable to California sources by applying an apportionment formula to the net income of the entire business.

Thus, in administering the California franchise tax, the Franchise Tax Board stresses substance over form and applies the unitary concept to all unitary businesses, regardless of the form in which that business is conducted. We believe that this appoach is logical and rational. We know of no decision of this Court which even hints that this approach is unconstitutional. However, in the current appeal Chase argues that the application of the unitary concept has resulted in unconstitutional taxation of property and income of individual corporations which do no direct business in California.

In that regard, it is appropriate to note that application of the combined unitary method to unitary businesses conducted in multicorporate form is nothing new or novel. It has been followed in California since the early years of the California franchise tax, which was originally enacted in 1929. Since the inception of the franchise tax, use by California of the combined unitary method, *per se,* has been challenged in the courts only once, in addition to the instant case. That was the case of *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 183 P.2d 16, which dealt with the income years 1936 and 1937. In *Edison Stores,* the California Supreme Court rejected the argument that use

of the combined unitary method resulted in taxing extra-territorial values and held that such method was authorized by statute and was consistent with constitutional principles. The Court also found no difference in principle between a single-corporation unitary business and a multiple-corporation unitary business:

> "[T]he business is unitary regardless of the fact that in the Butler Brothers case there was but one corporation involved, owning as parts of the unitary system seven different branches in as many states, and that in the present case there is a parent corporation owning and controlling as units of one system fifteen different branches organized as corporations in as many states. No difference in principle is discernable. If the crux of the matter is to ascertain that portion of the business which is done within this state, then the same considerations justify the use of the formula allocation method in the one case as in the other." *Id.* at 480; 183 P.2d at 21.

The fact that in more than four decades only one other taxpayer has challenged the use of the combined unitary method *per se* is strong evidence that taxpayers generally feel that such method is proper, constitutional, and generally productive of the correct result. As stated by Justice Cardozo in *Coler v. Corn Exchange Bank,* (1928) 250 N.Y. 136; 164 N.E. 882, 884:

> "Not lightly vacated is the verdict of quiescent years."

Moreover, throughout the years various legal writers have commented upon the combined unitary method and recognized it as a proper method of computing income. See, for example, Altman & Keesling, *Allocation of Income in State Taxation,* 2d ed (1950), pp. 169-178; Keesling & Warren, "The Unitary Concept in the Allocation of In-

come," 12 Hastings Law Journal 42, 57; Hellerstein, "Recent Developments in State Tax Apportionment and Circumscription of Unitary Business," 21 National Tax Journal 487; Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups," 25 Tax Law Review 171, 194. We know of no writer who has suggested that use of the combined unitary method is *per se* unconstitutional.

We submit that it cannot be seriously disputed that if a parent corporation and its wholly-owned subsidiaries are engaged in a unitary business within and without California, the Franchise Tax Board may properly determine the amount of income attributable to California sources by the combined unitary method.

II. The Activities of Kennecott, Kennecott Sales, Chase and Kennecott Wire Constitute a Unitary Business.

It takes only a moment's reflection to realize that the question of what constitutes a unitary business cannot be answered by a simple checklist of objective facts. The range of business relationships is far too varied. Some unitary businesses are horizontally structured enterprises, such as in *Butler Bros. v. McColgan,* (1942) 315 U.S. 501. Other unitary businesses are vertically structured enterprises, such as in *Underwood Typewriter Co. v. Chamberlain,* (1920) 254 U.S. 113. Yet other unitary businesses are such because of strong central management, common financing and centralized departments which handle such matters as accounting and insurance which tie together otherwise operationally independent divisions, such as in *General Motors Corp. v. District of Columbia,* (1965) 380 U.S. 553. It is readily apparent that the type of fact which indicates

that a horizontally structured business is unitary, such as centralized purchasing of a product sold by all branches, will ordinarily not be present in a vertically structured business. Therefore, a general test is needed.

A succinct statement of the general rule which has consistently been followed by the California courts and which was followed by the California Court of Appeal in the instant case was made by the California Supreme Court in *Edison California Stores v. McColgan* (1949) 30 Cal.2d 472, at 481; 183 P.2d 16, at 21:

> "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary; . . ."

Surely that statement captures the essence of the rule. The unitary principle applies and formula apportionment is proper when the activities of one member of the affiliated group are dependent upon or contribute to the activities of the other corporations and the success of the group as a whole.

It cannot seriously be denied that the test of mutual contribution and dependence is fully satisfied in this case. Kennecott and its subsidiaries present a clear-cut example of a vertically structured manufacturing and selling business which by its very nature constitutes a unitary business.

As a group, Kennecott and its copper selling and fabricating subsidiaries are engaged in various phases of the copper business, from mine to consumer. Kennecott mines, concentrates, smelts and refines the copper ore. Chase and Kennecott Wire take refined copper and convert it into consumer products. Surely the entire operation is a unitary business. To contend that the fabricating operations of

Chase and Kennecott Wire are truly independent businesses is equivalent to contending that the assembly plant operations of General Motors constitute a separate business. The contention would be preposterous.

The dependence of Chase and Kennecott Wire upon Kennecott is undisputed. There are only three large producers of refined copper in the United States—Kennecott, Anaconda and Phelps Dodge. Undisputed testimony proved that Anaconda and Phelps Dodge sell most, if not all, their refined copper to their fabricating subsidiaries. Thus, if Chase and Kennecott Wire were to acquire refined copper, their basic raw material, at a competitive price, it had to come from Kennecott. During the period involved in this litigation, the only other source of domestic copper was the "custom smelters", whose price was higher.

Chase and Kennecott Wire, on the other hand, contributed to the success of Kennecott. Appellant's attempt to have this Court treat the activities of Chase as a separate business in which Kennecott has no interest other than that of a shareholder who has invested some idle funds completely overlooks the history and structure of the copper industry. It is not possible to brush off Chase's reliance on Kennecott and Kennecott's use of Chase as nothing more than mere market place encounters of an independent buyer and seller.

It is certainly not appropriate here to go into detail on all the economic advantages realized by a mining company which controls a fabricating subsidiary or how the ownership of a fabricator aids the mining parent in its attempt to control and stabilize the price of the metals market. The vital relationship between copper producer and copper fabricator is vividly displayed by Kennecott's

attempt to acquire the Okonite Company. Following a study of Kennecott's position in the copper market, in 1958 Frank R. Milliken, then a vice-president of Kennecott, submitted a memorandum entitled "Acquisition of the Okonite Company" to the Board of Directors of Kennecott. The memorandum states in part:

> "It is recommended that Kennecott acquire The Okonite Company, producers of insulated wire and cable, because the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper and will also provide a second profit on copper produced." (Stipulation, Exhibit F.)

The California Court of Appeal in *Chase* I recognized that, although federal law required Kennecott to sell to Chase and to Chase's competitors at the same price, Kennecott's control of Chase provided Kennecott with a guaranteed buyer of a substantial portion of Kennecott's production. J.S. App. 21.

From the fabricator's point of view, Chase's witness testified that if it were not for Kennecott, Chase and Kennecott Wire simply would not have a source of supply of copper. RT (1966) 122. It is hard to imagine a situation of greater dependence upon the parent corporation.

It is submitted that each of the members of the Kennecott family of corporations involved in this case played a vital role in the copper business owned and controlled by Kennecott. Chase and Kennecott Wire both played significant parts in that unitary business.

In its Jurisdictional Statement, appellant all but ignores these overwhelming facts showing contribution and dependency. Rather, appellant concentrates on the significant, but less important, factors such as common retirement

plans, executive control of salaries, etc. In doing so, appellant does a disservice to the Franchise Tax Board and to the opinion of the California Court of Appeal. The Franchise Tax Board's determination to use the combined unitary approach in this case was based essentially on the fact that Chase and Kennecott Wire were dependent upon Kennecott for their basic raw material. The facts discussed by appellant are merely supplemental and give further proof of the unitary nature of the business. Individually they are not the touchstone of the Board's determination. For example, if Chase were not in the copper fabricating business but did nothing more than produce motion pictures for television, the Board would not have used the combined unitary method, regardless of the fact that some common retirement plans existed.

Chase apparently recognizes that it cannot expect success if it presents the facts in a fair manner in its argument. Thus in quoting from the stipulation of facts on page 8 of its jurisdictional statement Chase deletes the following rather key fact:

> "The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." (Stipulation ¶ 5(a).)

Although Chase later (J.S. 18) recognizes that the Court in *Chase* I noted the subsidiaries' reporting of major policy matters to Kennecott, Chase fails to note the following statement in *Chase* I:

> "The major policy matters are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott." J.S. App. 19.

The purchasing, advertising, accounting,[6] legal, financial, retirement, policy, salary, sales and purchases links set out on pages 12 and 13 of the jurisdictional statement is an incomplete list of all the interconnecting factors within the multicorporate unitary business. There was also some intercorporate insurance coverage when it was beneficial (J.S. App. 17, 70-71); furthermore, Kennecott, by central control, determined the horizontal interrelationship between Chase and Kennecott Wire (J.S. App. 19);[7] on infrequent occasions there were loans of specialized personnel from Chase to Kennecott and from Kennecott to Chase (J.S. App. 74); Kennecott's annual reports interchangeably referred to Chase and Kennecott Wire as "fabricating subsidiaries" (Stip. Exh. A) and as its "fabricating divisions" (Stip. Exhs. B, C) and referred to the coordinated research and development activities of Chase and Kennecott regarding metals in which Kennecott was interested (Stip. Exhibits A, B, C).

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6. Chase mistakenly accuses (J.S. 12) the Court of Appeal in *Chase* I of saying Chase and Kennecott filed consolidated tax returns; the *Chase* I decision (J.S. App. 17) spoke of consolidated tax "accounts", relying on the statement regarding consolidated accounting and tax reports in paragraph 19(f) of the stipulation (J.S. App. 73).

7. It was the "major part" of the sales of Kennecott Wire's products which Chase assumed, with orders filled and shipped in the names of Chase (J.S. App. 20, 66); during the years in question Chase did the accounting and reviewed taxes for Kennecott Wire (J.S. 20, 73); a president and a general sales manager for Kennecott Wire came from Chase (J.S. 20, 71).

Thus the record is clear in establishing the dependent and contributory nature of the operation of this multicorporate unitary business, both in the vital area of supply and sales of Kennecott's basic product, copper, and in the area of intercorporate unity of ownership, operation, and use. *Chase* I and *Chase* II properly held that Chase was engaged in a unitary business with Kennecott, Kennecott Sales, and Kennecott Wire.

III. California Has Properly Applied the Standard Three-Factor Formula to the Unitary Net Income in Determining What Portion of That Net Income Was Attributable to California.

California in this case applied the standard three-factor formula of property, payroll and sales to determine the amount of unitary net income attributable to California. California's application of this formula to unitary businesses was approved by this Court in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. The general use of the "standard three-factor formula" has been noted with approval by this Court in *Gen. Motors v. District of Columbia* (1965) 380 U.S. 553, 559, 561. The California Court of Appeal in its *Chase* II opinion presents a well-reasoned response (J.S. App. 40-54) to the myriad challenges Chase raised below to the Board's application of this formula in this case. The specific challenges raised in Chase's jurisdictional statement shall be dealt with below.

IV. The Facts Relied Upon by Appellant Are Not Persuasive. Appellant's Legal Arguments Are Unsupportable.

It is often difficult to discern separately each argument Chase is attempting to make in its jurisdictional statement. In this section we shall attempt to pick out the factors and legal contentions relied upon most heavily by appellant and demonstrate the errors in Chase's position.

A. CONTRARY TO CHASE'S CONTENTION, THE RESULT BELOW WAS BASED ON MUCH MORE THAN COMMON OWNERSHIP OF THE COMPANIES INVOLVED IN THE UNITARY BUSINESS.

The close interrelationship between Chase, Kennecott, and the other companies formed in *Chase* I and II to be engaged in the unitary business has been summarized above at pages 15-21 and in the *Chase* I decision (J.S. App. 12-14, 16-21). Chase sets forth some of the facts showing this interrelationship at pages 12 and 13 of its jurisdictional statement. Yet during the course of its jurisdictional statement Chase impliedly recognizes how tenuous its position is in this matter under the facts as they actually existed. Thus Chase is reduced to a claim that "[t]he tax imposed is imposed solely because Chase's stock is owned by a single corporation. . . ." J.S. 32. Similar statements occur through Chase's jurisdictional statement. J.S. 18, 19, 24, 32, 33, 34.

A reading of *Chase* I and *Chase* II reveals the ridiculous nature of Chase's desperate claim. Unity of ownership was only one test in determining the unitary nature of the business herein involved. It was discussed in three sentences in *Chase* I. J.S. 16, 20. Although unity of ownership was necessary to a conclusion that a unitary business existed, the other tests and reviews of interrelationships discussed above at pages 15-21 were also made in reaching that conclusion. Furthermore, *Chase* I found two other wholly owned subsidiaries of Kennecott (Braden Copper Company and Bear Creek Mining Company) to *not* be part of the unitary business which included the other corporations (J.S. App. 21-22).

Chase's appeal apparently is built upon the foundation of its claim that the finding of a unitary business was based solely upon Kennecott's ownership of its subsidiaries, including Chase. That foundation is totally without support in the record.

B. THE FACT THAT CHASE, KENNECOTT WIRE AND KENNECOTT SALES ARE SEPARATELY INCORPORATED IS NOT DETERMINATIVE.

Appellant appears to lay great stress (J.S. 17, 20) upon the fact that Chase is separately incorporated. Appellant's reliance upon that fact is misplaced. As demonstrated earlier, the unitary concept applies to all corporate activities that are tied together by mutual contribution and dependence. For decades the Franchise Tax Board and the California Courts have applied the rule based on the substance of the activities in question rather than by the form in which the activities are carried on. *See Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 183 P.2d 16.

To have determinations based on substance rather than form is just plain good common sense. While some states might elect to be bound by form, surely there is nothing in the United States Constitution that would require California to recognize form over substance. There is no constitutional principle which guarantees corporations the right to change their state tax consequences merely by changing the form in which they do business. In *Helvering v. Lazarus & Co.* (1939) 308 U.S. 252, this Court, in holding that a sale and lease back of real property was in reality a mortgage, stated, at page 255,

> "In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, . . ."

Suppose that Kennecott, as sole shareholder of Chase, Kennecott Wire and Kennecott Sales, elected to reorganize and merge each of the subsidiaries into Kennecott. It could do so very easily without any material alteration in operational practice. Any changes would be merely formal. For example, the title of the individual who is the head of

Chase would be changed from "President" of Chase to, possibly, "Vice President: Chase Division" of Kennecott. If such a merger did occur, then Kennecott itself would be doing business in California and no one would seriously question the right of California to compute the measure of its franchise tax by applying an apportionment formula to the net income of the corporation. A different result should not be reached simply because Kennecott has certain portions of its business conducted by wholly-owned subsidiaries rather than by divisions of the parent company.[8]

C. CONTRARY TO CHASE'S ARGUMENTS, CALIFORNIA IS NOT TAXING KENNECOTT; IT IS TAXING CHASE WITH A TAX MEASURED BY THE PORTION OF THE UNITARY BUSINESS' NET INCOME ATTRIBUTABLE TO CHASE'S CALIFORNIA ACTIVITIES.

Chase argues (J.S. 14-16, 18) that California is taxing *Kennecott's* property and income although Kennecott does no business in California. This argument has no weight once the unitary relationship between Chase and Kennecott is established. California is not attempting to levy any kind of tax on Kennecott for the years involved. Application of the apportionment formula to the entire unitary business does not result in a taxing of Kennecott's income, or even a taxing of Chase's income from its activities outside California. Rather, the formula just tells us the true amount of income attributable to Chase's activities in California. *See Butler Bros. v. McColgan* (1942) 315 U.S. 501, 506, 509.

8. As noted above, Kennecott's annual reports for the years involved interchangeably referred to Chase and Kennecott Wire as "fabricating subsidiaries" (Stip. Exh. A) and as "fabricating divisions" (Stip. Exhs. B, C).

D. BEFORE FINDING THAT A UNITARY BUSINESS EXISTS, THERE IS NO NEED TO ESTABLISH THAT ACCOUNTING PROCEDURES HAVE BEEN USED TO SHIFT INCOME ARTIFICIALLY BETWEEN CORPORATIONS.

Throughout its jurisdictional statement Chase has referred to the "consolidation" of Chase with Kennecott and other corporations. J.S. 7, 9, 11 n. 5, 19, 21, 22, 24. Although the term "consolidation" is used sometimes to describe the process of determining that corporations are combined in engaging in a unitary business, that term can also be applied to a situation where consolidated returns are required solely because a parent company has artificially shifted income between companies for tax purposes. These are two different situations, governed by two separate statutes in California. Cal. Rev. & Tax. Code §§ 25101, 25104 (set forth in Appendix A attached hereto). The power to apply unitary formula allocation is not derived from the power to require consolidated returns of two or more corporations. *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 480; 183 P.2d 16. Thus to find a unitary business there is no need, as Chase suggests (J.S. 20-21, 32-34), to establish that there was intentional falsification or bad faith in the manner of bookkeeping. *See id.* at 475.

E. THE UNITARY CONCEPT IS VALID IN FRANCHISE TAX CASES AS WELL AS INCOME TAX CASES.

Appellant apparently contends (J.S. 23-24) that even if Kennecott and its subsidiaries constitute a unitary business, the unitary rule cannot be followed because this is a franchise tax case, not an income tax case. That argument demonstrates the lengths to which appellant feels it necessary to go in order to find an argument to support its position.

It is ridiculous to contend that the combined unitary method is valid in income tax cases but invalid *per se* in franchise tax cases. The issue would be the same in either

case, namely, has California used a reasonable method to compute the amount of income attributable to California sources? If the combined unitary method is a proper accounting technique to determine the amount of income attributable to California sources for income tax purposes, it most certainly would be a proper accounting technique for franchise tax purposes.

The action by this Court in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal.2d 214, 238 P.2d 569, is significant. In *John Deere* the California Supreme Court upheld the application of the combined unitary concept to a group of 85 affiliated corporations engaged in a unitary business. Of that affiliated unitary group, only one subsidiary did business in California. The tax involved was the California franchise tax, the very same tax which is involved in this case. The taxpayer appealed to this Court. This Court, in a *per curiam* opinion, cited *Butler Bros. v. McColgan, supra,* and dismissed the appeal for want of a substantial federal question, 343 U.S. 939. That action certainly refutes the contention that use of the combined unitary method is invalid *per* se in franchise tax cases.

F. UNDER BUTLER BROS. V. McCOLGAN A TAXPAYER MAY NOT USE SEPARATE ACCOUNTING TO REFUTE THE CALIFORNIA NET INCOME DETERMINED BY APPLICATION BY THE THREE-FACTOR FORMULA; CHASE'S RELIANCE ON THIS COURT'S DECISIONS IN NORFOLK & WESTERN RY. V. MISSOURI TAX COMM. AND HANS REES' SONS V. NO. CAROLINA IS MISPLACED.

The heart of Chase's jurisdictional statement (J.S. 18-22) consists of attempts by Chase to use figures from the separate books of Chase and Kennecott to impeach the procedures used and the results reached in applying the three-factor formula to reach California net income. This is exactly the sort of separate accounting which this Court has determined cannot be used for such purposes. *Butler*

Bros. v. McColgan (1942) 315 U.S. 501. Chase relies on two cases in an attempt to support its approach. They shall be discussed separately.

1. Norfolk & Western Ry. v. Missouri Tax Comm.

The one legal decision relied on more than any other by appellant is *Norfolk & Western Ry. v. Missouri Tax Comm.* (1968) 390 U.S. 317. We submit that a close reading of the case reveals that appellant's reliance is misplaced.

The *Norfolk & Western* case did not involve the proper methods of taxing the income of a multistate business. Rather, the question presented involved determining the value of railroad rolling stock in the State of Missouri on tax day for ad valorem property tax purposes. Missouri arrived at the assessment of rolling stock by first determining the value of all rolling stock of the railroad regardless of where located. That figure ($513,309,877) and the method of its derivation were not in issue. That figure was then equalized to bring it to the relative level of other Missouri property assessments. Missouri next determined the percentage of track of the railroad system located in that state and applied that percentage to the equalized total value of the rolling stock to arrive at the assessed valuation of rolling stock in Missouri. This method proceeded on the assumption that as a matter of fact on tax lien day the rolling stock of the railroad was evenly distributed throughout the railroad's system. That factual assumption was proven to be false because the railroad was able to show by actual inventory count the rolling stock in Missouri on tax day. The railroad, using the same valuation method as the state but determining the value of its rolling stock in Missouri by reference to the actual inventory count, determined that the proper assessed value was approximately $7,600,000,

while the factual assumption adopted by Missouri yielded an assessed value of $19,981,000. Since there was no dispute as to the total value of all the railroad's rolling stock, the only matter to be determined by the Tax Commission was how much of that rolling stock was in Missouri on tax lien day. It is quite obvious that this Court correctly determined that the Tax Commission had miscalculated. It was as if the Tax Commission had said, "Mr. Railroad, I have determined that on tax lien day you had 100 railroad cars in Missouri," and the railroad was able to show by actual count that it had only 75 cars in Missouri on that day.

It is also clear from the opinion why this Court could not sustain the assessment based on any theory of "enhanced" value. Property within a state may have an "enhanced" or "going concern" value that is greater than its value when considered separately. The "enhanced" or "going concern" value attaches to the entire property, considered as a unit. But the Tax Commission was clearly foreclosed from making any such "enchancement" argument on the record in the *Norfolk & Western* case since it had found that the total value of all the rolling stock was $513,309,877. Since that figure was computed by applying depreciation directly to "original cost" figures, *id.* at 321, it was clear that the Tax Commission had *not* included any "enchanced value" factors in its calculations. Moreover, as noted by this Court, the Tax Commission did not rely on any "enhanced" value theory either in making the assessment or when defending the assessment before the Missouri Supreme Court. *Id.* at 323.

Case attempts to use the *Norfolk & Western* case to support Chase's use of separate accounting figures in attacking the California court's holding regarding the net income which has been attributed to California under

the three-factor apportionment. In doing this Chase attempts to evade this Court's clear holding, in *Butler Bros. v. McColgan* (1941) 315 U.S. 501, that separate accounting cannot be used to impeach the formula apportionment of income of a unitary business.

Chase would have this Court treat the measurement and allocation of unitary income exactly the same as the determination of location and valuation of tangible property. There are obvious and immense differences between the two processes. The allocation of unitary net income is not based on an assumption that income is distributed evenly in all states in which the unitary business is active. It does look to the distribution of factors which indicate *contributions* to income. *See Butler Bros. v. McColgan,* 315 U.S. at 509; *Chase* II, J.S. App. 44, 50, 53. While a showing of where property actually was can defeat a contrary assumption in an *ad valorem* property tax situation, a showing (through separate accounting) of where income of a unitary business was actually *received* "wholly fails to sustain" an objection to formula allocation. *Underwood T'Writer Co. v. Chamberlain* (1920) 254 U.S. 113, 120-21; *Butler Bros. v. McColgan,* 315 U.S. 501. This would also apply to a showing of which segment (division, subsidiary, etc.) of the unitary business actually received the income which was generated by the entire unitary business. Thus if a unitary business has as one of its parts a subsidiary corporation which only does research relating to development of products, and if that research subsidiary is totally located in a state in which the unitary business makes no sales, it is clear that income could and should be allocated to that state and to that part of the unitary business even though *no* income is actually received in that state.

The "enhancement" theory discussed in *ad valorem* tax cases such as *Norfolk & Western* has no application in the determination and allocation of the net income of a unitary business. It is impossible to allocate specifically the profits earned by the processes conducted by a unitary business within the borders of a particular state. *Butler Bros. v. McColgan,* 315 U.S. at 507. A fairly calculated formula allocation is used as a reasonable method to attribute such net income to a particular state. *Id.* at 506. The result of such allocation is taken to *be* such net income, and contrary results arising from separate accounting cannot be used to impeach that result. *Id.* at 507. Thus it is not a situation where, as Chase claims (J.S. 23-24), the Board has the burden of proving the "enhancement" of separate accounting results by the existence of unitary relationships in order to reach the formula allocation results;[9] the separate accounting results simply are not relevant as a comparison point to the formula results.

Norfolk & Western Ry. v. Missouri Tax Comm. provides no support for Chase's position.

2. Hans Rees' Sons v. No. Carolina.

Chase also relies upon *Hans Rees' Sons v. No. Carolina* (1931) 283 U.S. 123. In that case this Court found a single-factor formula led to an unreasonable result. It was cited on this basis by the California Supreme Court in *Butler*

9. In fact, the unitary approach to income determination may actually produce a *lower* California tax. *See Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal.2d 406, 386 P.2d 33, and *Honolulu Oil Corp. v. Franchise Tax Bd.* (1963) 60 Cal.2d 417, 386 P.2d 40, wherein the California Supreme Court agreed with the *taxpayers'* insistence that (under the California law as it then existed) formula allocation *must* be applied to *all* unitary businesses, even when the resulting taxes are *less* than those which would result from the application of separate accounting.

Bros. v. McColgan (1941) 17 Cal.2d 664, 672-73, 111 P.2d 334, 339. Later when this Court was considering the *Butler Bros.* case, the *Hans Rees'* decision was cited to support the use of separate accounting to refute the California three-factor formula apportionment. As noted above, this Court in *Butler Bros.* rejected such use of separate accounting. *Butler Bros. v. McColgan* (1942) 315 U.S. 501, 506-09. The *Butler Bros.* treatment of the *Hans Rees'* decision was aptly summarized by the taxpayers *(including Chase and Kennecott)* on page 5 of their petition for rehearing in this Court in *Kennecott Copper Corp. et al. v. State Tax Commission of Utah* (1972), *appeal dismissed,* 409 U.S. 973:

> "(It can be persuasively argued that the *Butler Bros.* case overrules the *Hans Rees'* case since the latter seemingly relies upon separate accounting to impeach formulary apportionment, whereas *Butler Bros.* stands for the proposition that, at least where a unitary business is concerned, separate accounting is inherently incapable of impeaching formulary apportionment.)"

3. Chase's Separate Accounting May Not Be Used to Impeach California's Three-Factor Apportionment.

As shown above in the discussions of the *Norfolk & Western* and the *Hans Rees' Sons* cases, this Court clearly established in *Butler Bros. v. McColgan* (1942) 315 U.S. 501, that separate accounting cannot be utilized to impeach formula apportionment of the net income of a unitary business. That holding was reached in *Butler Bros.* even though the taxpayer's separate accounting, which "admittedly followed recognized accounting principles", *id.* at 505, showed a California loss of $82,851 for the same year that formulary apportionment established a California profit of over $93,500. Chase now refuses to recognize the *Butler Bros.*

holding.[10] Thus in the current case Chase uses separate accounting to attempt to split the unitary business along corporate lines as well as geographical lines (J.S. 19-22).

Even though the *Butler Bros.* case involved a situation when separate accounting showed a California *loss,* Chase tries to distinguish Chase's use of separate accounting regarding the 1955 flood loss on the basis that the loss in *Butler Bros.* had, according to Chase, "no demonstrated cause". J.S. 24-25. Yet, as noted above, no one in *Butler Bros.* questioned the fact that the loss shown under separate accounting was reached by following "recognized accounting principles". It was not necessary in *Butler Bros.* to delineate the cause of whatever financial setback resulted in the loss shown by separate accounting. In each case any such setback had its effect on the entire unitary business, reducing the apportionable unitary income for the year involved. Since the business involved in the current case is unitary, a loss such as the 1955 flood loss served to reduce the unitary net income; such a loss could not validly be attributed through separate accounting to only one of the interdependent parts of the business, as Chase is attempting to do here.

G. CHALLENGES (OTHER THAN BY SEPARATE ACCOUNTING) MAY BE MADE TO THE OUTCOME OF APPLICATION OF THREE-FACTOR FORMULA APPORTIONMENT; HOWEVER, CLEAR AND COGENT EVIDENCE MUST BE PRESENTED BY THE TAXPAYER TO SUPPORT ANY SUCH CHALLENGE.

On pages 25 through 29 of its jurisdictional statement Chase fabricates a classic strawman argument. In its attempt to have this Court accept jurisdiction Chase is making the eyecatching but absurd claim that the California

10. Chase even misapplies (J.S. 23) some federal treasury regulations in what amounts to a claim that said regulations are attempting to overrule this Court's *Butler Bros.* holding.

courts will not consider any challenge to any application of any apportionment formula. Chase bases this claim on the absence of quotation in California cases of one particular passage from *International Harvester Co. v. Evatt* (1947) 329 U.S. 416, 422-23.

In the *International Harvester* decision this Court upheld an Ohio apportionment, noting that "'rough approximation rather than precision' is sufficient." *Id.* at 422. The Court also observed that a state's effort to make an apportionment could be nullified, but only if "a palpably disproportionate result" had come from it. *Id.* at 422-23. Chase's argument is that since the subsequent California decisions have not quoted this last observation, California does not recognize that apportionment can ever be subjected to constitutional attack.

To the contrary, the California courts have always recognized that an apportionment formula can be challenged on constitutional grounds. The California decisions have not quoted the dictum from *International Harvester* on this point;[11] instead they have referred to language from this Court's *Butler Bros.* decision which sets forth the type of burden which must be surmounted by anyone making such a challenge.

In *Butler Bros. v. McColgan* (1942) 315 U.S. 501, 507, this Court noted that "[o]ne who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extra-territorial values being taxed." The California cases consistently have reflected and applied that approach. In *Household Finance*

11. It may be of interest to note that of the eleven times this Court has cited the *International Harvester* decision, the only time the "palpably disproportionate result" language has been quoted was in Mr. Justice Black's dissent in *Norfolk & Western Ry. Co. v. Missouri State Tax Comm'r* (1968) 390 U.S. 317, 332.

Corp. v. Franchise Tax Bd. (1964) 230 Cal.App.2d 926, 931, 41 Cal. Rptr. 565, 568, which Chase cites (J.S. 26) as disregarding the possibility of any attack, the court in fact noted the taxpayer's burden of producing "'clear, cogent evidence'" in attacking the elements of the formula in order to show unfair apportionment to California.

The disingenuous nature of Chase's argument is shown by reference to a case of which Chase is fully aware but which Chase chooses not to cite to this Court. In *McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 Cal.2d 506, 512-15, 72 Cal. Rptr. 465, 468-70, 446 P.2d 313, 316-18, the California Supreme Court referred to the taxpayer's burden as noted in *Butler Bros.* and *held that the taxpayer had satisfied that burden in its attack on how the Franchise Tax Board had computed the property factor* in that case. Chase's attorneys are certainly aware of the *McDonnell Douglas* decision. In fact, it was cited in *Chase* I (J.S. App. 22) as the conceded intervening cause for the need to adjust the property factor in the remand in this case, and it was cited often by both parties in the *Chase* II briefs.

Thus Chase's argument is shown to be utterly false. If the California courts' approach was as stated by Chase, the decision in *Chase* II would have been considerably shorter; however, instead of holding that the apportionment result was immune to attack, the *Chase* II decision considered the many challenges Chase had made to the procedures followed by the Board.[12] Contrary to Chase's argument, the California courts clearly recognize the ability of a taxpayer to challenge an apportionment result.

12. Of course *Chase* II did note and follow (J.S. App. 44-45) the rule from *Butler Bros.* to the effect that an attack which is based upon the application of separate accounting to portions of a unitary business is not an allowable form of challenge. See discussion above at pages 26-32.

H. CHASE HAS PRESENTED NO CLEAR AND COGENT EVIDENCE WHICH WOULD SUPPORT DEVIATIONS FROM THE APPORTIONMENT FORMULA AFFIRMED IN CHASE II.

On pages 35 through 37 of its jurisdictional statement Chase presents two challenges to the formula which was affirmed in *Chase* II; one of those challenges relates solely to the property factor, and the other concerns Kennecott's business in gold, silver and molybdenite which was held in *Chase* I to not be part of the unitary business.

1. The property factor is a fraction, the numerator of which is all the California property of the unitary business and the denominator of which is the total property everywhere of the unitary business. Chase's argument regarding the property factor is based on a claim that the business' California property was valued at what Chase calls "current value" whereas the out-of-state mines were valued at original cost. J.S. 36. Chase's claim is not supported by the record. Reference is made to *Chase* II for a full discussion (J.S. App. 45-48) of the valuation of the mines, including a recognition that Chase's proposed use of the "Hoskold's Formula" is only a rough approximation. In any event, in computing the property factor original cost was used as to each piece of property, whether or not it was in California. Chase now recognizes this as to the mining properties; however, as to the California property Chase *deletes* from its Appendix G the language from paragraph 11(a) of the stipulation of facts which establishes that *original cost was used as to each piece of California property.*[13] The facts cannot be discarded so easily.

13. "The amount of all depreciable California property as used in the allocation schedule and in the deficiency tax assessed by defendant and herein in issue was federal tax basis which was the same as net book value, i.e., cost less depreciation. As inventories and land are not depreciable, their amount was computed at cost. Freight to California was included in this cost. Chase calculated its inventory costs on the Lifo (Last In—First Out) basis."

The record does not show when the California property, consisting of real estate, office furniture, fixtures, machinery and equipment as well as inventories, was acquired. There is nothing to support Chase's implied claim that it was *all* acquired in 1954.

Thus original cost was used both in the numerator and the denominator of the property factor. As pointed out in *Chase* II (J.S. App. 47), the current California statute (reflecting the later adoption by California of the Uniform Division of Income for Tax Purposes Act) clearly provides for the valuation of property at its original cost. This is consistent with the need for practical tax administration: it should always be possible to determine the original cost of property from the books of a business, whereas the determination of present fair market value of each asset of a company would encompass considerable turmoil, uncertainty and complications. The Board's practice of balancing original cost against original cost on the property factor certainly at least satisfies the "rough approximation" standard set in *International Harvester Co. v. Evatt* (1947) 329 U.S. 416, 422.

2. Chase objects (J.S. 36-37) to the manner used by the Board and approved in *Chase* II for adjusting the property and payroll factors in response to the *Chase* I holding that for the years at issue Kennecott's business involving metals other than copper was not part of the unitary business. Said adjustments are summarized generally in *Chase* II as follows:

> "After the remand, the Board first determined the percentage relationship between the sales of other metals and total sales for each year; then it applied this percentage to the payroll and property factors and subtracted the resulting amounts from the total payroll and total property factors to obtain the final denominator for each factor."
>
> J.S. App. 51-52 (footnote omitted).

This approach was based on the Board's position that, as affirmed in *Chase* II (J.S. App. 52-53) the other metals were joint products with the copper. In its jurisdictional statement Chase does not now challenge the treatment of the other metals as joint products with the copper; what Chase does challenge is the accuracy of the figures used in separating those joint products for purposes of adjusting the property and payroll factors.

The irony of Chase's present position is that, when the Board first revised its figures in 1971 in preparation for the remand trial after *Chase* I, the Board used the best figures then available to it, and *invited Chase to supply more exact figures to be used by the Board in applying its joint products approach.* Yet Chase never offered figures into evidence at the remand trial to establish that, in applying the *Board's* joint products theory, more exact figures would lead to factor adjustments more favorable to Chase. In fact, as shown in affidavits filed in *Chase* II, when Chase finally did supply some more exact figures to the Board, and the Board applied these figures and reported to Chase that use of those figures apparently would *increase* Chase's tax liability, Chase broke off correspondence on this point.

Even given the lack of detail of the figures the Board had to work with, the Board's adjustment of the payroll factor was reasonable since it was based on the relative sales ratio being applied to *all* of Kennecott's payroll, including payroll at mines and other facilities producing no molybdenite as well as payroll at those facilities producing considerable amounts of molybdenite. Chase looks at the resulting figure only with regard to facilities which produced no or very little molybdenite and claims that the Board has overstated the amount of Kennecott payroll which is attributable to the other metals. Chase ignores

the fact that the figure reached by the Board would appear to be understated if one were only to look at the facilities which produced much molybdenite. Chase would also apply its myopic approach to scrutiny of the property factor; it is submitted that the same principles apply to render reasonable the Board's property factor computations.

An analogy would be to consider a person with three paper bags, one with ten apples, one with two apples, and one with no apples. Obviously the average is four apples per bag. Yet Chase would point at the empty bag and say that any such result is a "palpable error" which cannot be ignored.

I. THERE CAN BE NO VALID CHALLENGE IN THIS CASE ON GROUNDS OF MULTIPLE TAXATION TO CALIFORNIA'S USE OF THE STANDARD THREE-FACTOR APPORTIONMENT FORMULA.

On pages 29 through 32 of Chase's Jurisdictional Statement Chase claims that this Court should take jurisdiction because of its argument that the holding in this case, when viewed with the Utah case of *Kennecott Copper Corp., et al. v. State Tax Commission of Utah* (1972) 27 Utah 2d 119, 493 P.2d 632, *appeal dismissed,* 409 U.S. 973, would lead to double taxation. In the Utah case, decided after review of *Chase* I had been rejected by this Court, the taxpayer applied the standard three-factor formula to its unitary business. After noting a great drop in tax revenues arising from this formula, the Utah Supreme Court agreed with the Utah taxing authorities that the standard formula should not be followed and that formula apportionment should be applied to segments of the unitary business only *after* making a segregation of the unitary income through the use of separate accounting. Through this method the Utah tax revenues were increased significantly, although

the dissent in the Utah Supreme Court noted that the Uniform Division of Income for Tax Purposes Act (UDITPA) had the assumption that the standard three-factor formula would normally be applied by all states and "'that 100 percent of income, and no more and no less, would be taxed.'" 493 P.2d at 638.

The taxpayers in the Utah case, *including Chase as well as Kennecott,* appealed to this Court (No. 72-319). They claimed that the Utah decision led to unconstitutional multiple taxation, and they recognized the power of other states to continue to apply a three-factor formula. On page 18 of their 1972 jurisdictional statement appellants recognized that states other than Utah "have every right, constitutionally, to impose a tax on a fair share of corporate income." Taxpayers continued as follows:

> "Again, we know of no argument which could be made . . . to persuade those states that they should somehow defer to Utah in the matter. It has been twice held that the corporation conducts a unitary business; [footnote omitted citing *Chase* I and the Utah decision] therefore, *any state would clearly be justified in taxing a portion of total corporate income as apportioned by the three factor formula.*" (Emphasis added; footnotes omitted.)

The State of California filed in this Court an *amicus curiae* brief in favor of the taxpayers in the Utah case, in which we argued that Utah's *divergence* from the standard treatment of multistate unitary businesses appeared to present a serious federal question to which the Court might want to address itself. As noted below, this was not a recognition that application of the standard three-factor formula would present a substantial federal question. This Court dismissed the appeal in the Utah case for want of substantial federal question. 409 U.S. 973 (1972).

For the following reasons, there is no significant federal question regarding double taxation presented here:

1. In testing whether a state taxing statute would result in unconstitutional multiple taxation, this Court looks to the result which would occur if other states adopted the *same* approach as the statute being tested. *See Adams Mfg. Co. v. Storen* (1938) 304 U.S. 307, 311; *Western Live Stock v. Bureau* (1938) 303 U.S. 250, 255-56. Here California has used the standard three-factor formula allocation approved by this Court in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. Further, this Court has recognized "the context of general use of the three-factor approach". *Gen. Motors v. District of Columbia* (1965) 380 U.S. 553, 559. Thus the fact that Utah has used a method diverging from the standard method used by California and other states does not give rise *in the current case* to a constitutional question of multiple taxation. This was recognized in the above quotation from the taxpayers' (including Chase) jurisdictional statement in the Utah case.[14]

2. Contrary to the result of the uniform use of the three-factor formula, if *all* states adopted the Utah approach, there would be multiple taxation. If the Utah procedure presented no substantial federal question, as this Court held contrary to our *amicus* position in 1972, then the application of the standard three-factor formula by California certainly presents no substantial federal question.

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14. It was also stated, on page 7 of the *amicus* brief (in the Utah case) of the Committee on State Taxation of the Council of State Chambers of Commerce and the National Association of Manufacturers, that when one state, such as Utah, taxes more than its apportioned share of income "the other states cannot be expected to, and will not, reduce their taxes to accommodate the overreaching state."

3. For the tax years involved in this case the Utah case can present no constitutional question of multiple taxation. The case at bar involves the years 1954 through 1956. The Utah case deals with the Utah law only as it existed after a 1967 change to said law.

V. The Arguments of Amici Curiae Are Untenable.

Briefs have been filed in this matter in which amici curiae Financial Executives Institute and Tax Executives Institute Inc., Committee on State Taxation of the Council of State Chambers of Commerce, and National Association of Manufacturers have argued in support of appellant Chase's position. No substantial arguments have been raised in those briefs which have not been answered in the balance of this motion to dismiss or affirm; thus no separate response shall be made to said briefs.

CONCLUSION

For the reasons set forth above, it is submitted that this Court should dismiss this appeal or, in the alternative, affirm the decision of the California Court of Appeal.

DATED: December 16, 1977

Respectfully submitted,

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Appendix A

Section 25101 of the California Revenue and Taxation Code (as renumbered from section 24301 in 1955) provided as follows during 1954 through 1956:

> 25101. When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State; provided, however, that any such factors or other method of allocation shall take into account as income derived from or attributable to sources without the State, income derived from or attributable to transportation by sea or air without the State, whether or not such transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country. Income attributable to isolated or occasional transactions in states or countries in which the taxpayer is not doing business shall be allocated to the state in which the taxpayer has its principal place of business or commercial domicile.
>
> If the Franchise Tax Board reallocates net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to him the basis upon which its reallocation has been made.

Section 25104 of the California Revenue and Taxation Code (as renumbered from section 24303b in 1955) provided as follows during 1954 through 1956:

25104. In the case of a corporation liable to report under this part owning or controlling, either directly or indirectly, another corporation, or other corporations, and in the case of a corporation liable to report under this part and owned or controlled, either directly or indirectly, by another corporation, the Franchise Tax Board may require a consolidated report showing the combined net income or such other facts as it deems necessary. The Franchise Tax Board is authorized and empowered, in such manner as it may determine, to assess the tax against either of the corporations whose net income is involved in the report upon the basis of the combined entire net income and such other information as it may possess, or it may adjust the tax in such other manner as it shall determine to be equitable if it determines it to be necessary in order to prevent evasion of taxes or to clearly reflect the net income earned by said corporation or corporations from business done in this State.

Supreme Court, U. S.
FILED
DEC 22 1977
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the Court of Appeal of California,
First Appellate District

Appellant's Reply to Motion to Dismiss or Affirm

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In the Supreme Court of the United States

OCTOBER TERM, 1977

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Appellant's Reply to Motion to Dismiss or Affirm

Most of the argument in support of the State's Motion was anticipated by the Appellant and has been answered in its Jurisdictional Statement. This reply is limited to responding to the unanticipated.

1. In the footnote on page 35, the Board states that the record does not show when Chase's California property was acquired. Attached hereto as Exhibit A is a copy of the letter from C. R. Foote, Manager of Taxes of Chase Brass and Copper Co., dated September 29, 1972, which was admitted into evidence as Exhibit 3 at the trial held

on October 11, 1972. The Deputy Attorney General then handling the case stipulated that if Mr. Foote were in court and sworn as a witness he would testify "as stated in the letter and that he prepared these from the books and records." Reporter's Transcript, page 20. As a part of Exhibit A we have attached reproductions of pages 19 and 20 of that reporter's transcript, in order that the Court may observe the Appellee's stipulation at the trial and the fact that the letter was admitted to evidence without objection and as proof of the contents of the letter.

Accordingly, the fact is in the Record. The fact was relied upon by Appellant in its illustrative argument that California property was valued at current value and the out-of-state mines at an ancient value no longer representative of current value.

2. The Board has repeatedly referred to events occurring in 1958, and once to an event occurring late in 1956, which events were not relied upon by the Court of Appeal in support of the conclusion for which the Board now urges them. Presumably this was because the Court was cognizant of the validity of our contention that events occurring after the years in issue could not support the unitary nature of the business in the years before the Court. The principal example of the Board's use of later events in its Motion is in respect of the Okonite acquisition, which was recommended in 1958 by a vice-president of Kennecott. Motion, p. 18.

3. The Board would have this Court believe that *John Deere Plow Co. v. Franchise Tax Board*, 38 Cal. 2d 214, 238 P. 2d 569, appeal dismissed 343 U.S. 939, involved a contention that the Franchise Tax Board should not have consolidated the various corporations comprising the Deere group. Neither in the California Supreme Court, as the

opinion of that Court will demonstrate, nor before this Court, did John Deere Plow Co., contend that the various corporations in the group should not be consolidated. Hence that issue was not decided by either Court in that case. This argument by the Board is at page 25 of its Motion.

4. The Board has contended at page 14 of its Motion that its practice of consolidating commonly-owned corporations has been in existence for many years without challenge. In support of that contention the Board points to the fact that this is only the second reported case in which it has been challenged in court. The Board has not informed this Court that there are numerous cases pending in the California courts involving the same issue, which are being delayed in presentation for decision pending the outcome of this case.

This case has been well-known in California for years because it has been in the courts for years. It involves the income years 1954, 1955, and 1956. The trial court first decided the case in favor of Appellant in the preceding decade. The real explanation for the paucity of decided cases can be seen from those circumstances. The pace of litigation in the California courts is not fast.

5. We have been criticized at pages 33 and 34 for failing to mention *McDonnell-Douglas Corp. v. Franchise Tax Board*, 69 Cal. 2d 506, 72 Cal. Rptr. 465, 446 P. 2d 313 (1968). We do not see its relevance to the issues we have raised here, but it does not support the Franchise Tax Board's characterization of all evidence showing the arbitrary workings of the formula as untrustworthy separate accounting. Records of property owned and leased, receipts from aircraft sales drawn from corporate books of account, and certain other matters of evidence were what the California Supreme Court relied on in *McDonnell-Douglas*. There

the Franchise Tax Board had failed to include one class of property in the property factor, and the California Supreme Court disapproved what the Franchise Tax Board had done. The State Supreme Court had no occasion to consider whether the entire net income of a corporation as shown by its books and records under generally recognized accounting methods should be disregarded as "mere separate accounting."

6. The Board's Motion confuses the Board's attitude with that of the Court of Appeal. The Court of Appeal in Chase I held that the sales of copper by Kennecott to Chase were not enough to make the two businesses unitary with each other. Also it held that Kennecott's *copper operations* were unitary with Chase, not the entire corporate business. The Attorney General has never accepted that part of the decision as correct and continuously imputes his own views to the California Court of Appeal.

7. We have stated that separate accounting is a geographic concept limiting economic activities to the taxing state. The respondent agrees with that position (Motion to Dismiss or Affirm, p. 10, second paragraph), and acknowledges that that was the limit of the concept as used before this Court in *Butler Bros. v. McColgan*, 315 U.S. 501 (1942). Respondent asserts that the California Court of Appeal has expanded that concept (footnote 4 on p. 10 of its Motion) although that expansion is not obvious from the portions referred to, but in any case the respondent's expanded concept of separate accounting has never been approved by this Court.

CONCLUSION

This case should be given plenary consideration and the decision below reversed.

Respectfully submitted,

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LAWRENCE V. BROOKES
Suite 3810
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San Francisco, CA 94111
Attorneys for Appellant

(Exhibits follow)

Exhibit A

CHASE BRASS & COPPER CO.
—Incorporated—
Subsidiary of Kennecott Copper Corporation
20600 Chagrin Boulevard, Cleveland, Ohio 44122

Telephone 216 283-3900
September 29, 1972

CHASE

Valentine Brookes, Esq.
Brookes, Maier and Wilson
3810 Security Pacific Building
One Embarcadero Center
San Francisco, California 94111

Dear Mr. Brookes:
The following information is provided from the books of Chase Brass & Copper Co., Incorporated:

1. *Original Cost Values for Property Described* — *From Books @ December 31st*

	1954	*1955*	*1956*
Building	$286,762.25	$286,762.25	$286,762.25
Machinery & Equip.	137,289.22	137,289.22	137,348.59
Motor Vehicles	15,014.98	16,939.78	15,748.84

2. The building was capitalized in August, 1954. The machinery and equipment were acquired in 1954 except for $462.24 which was acquired in 1956. The motor vehicles were acquired at various times during each of the years involved.
3. The land was acquired on August 25, 1953.

If you have any questions on the above information please call me at (216) 283-3161. Although I will be out of the office next week my secretary will be able to reach me.

Very truly yours,
C. R. Foote
Manager of Taxes

CRF:rk

record, is the dates of acquisition and the original cost of these properties on the books at the close of business at each of the three years in question.

Mr. Klee, may it be stipulated that this letter may go in evidence as evidence of the facts stated in the letter to the same extent as if Mr. Foote were in court, were sworn and testified that he prepared the letter and the figures in it from the books and records under his supervision and control?

MR. KLEE: I will stipulate that if Mr. Foote were in court and were called and sworn he would testify precisely as stated in the letter. I will not stipulate Mr. Brooke's characterization of the letter is correct, simply that if he was called to testify he would state exactly what is stated in the letter.

THE COURT: All right, so stipulated.

MR. BROOKES: Very well, Your Honor, may I offer this as Exhibit—Plaintiff's Exhibit 1 and now may I ask—

THE COURT: I think the books are one and two and the letter is three.

(Thereupon the aforementioned items were marked and received as Plaintiff's Exhibits 1, 2 and 3, respectively, into evi lence)

MR. BROOKES: I have one question of Mr. Klee, concerning Plaintiff's Exhibit No. 3. Mr. Klee restrained from stipulating Mr. Foote would testify the books of account from which these figures were taken are under his supervision and that he took the figures from those books of account.

I have a witness who can prove that, who is here, Your Honor.

THE COURT: Is that stipulated to, Mr. Klee?

MR. KLEE: You put me in a dilemma. I have no way of knowing whether that is true or not. I will accept the fact that if he were sworn and testified—called to testify, he would state as stated in the letter and that he prepared these from the books and records.

MR. BROOKES: That is the essential part of what I asked Mr. Klee to stipulate to. Thank you, Mr. Klee.

THE COURT: Are you ready to proceed with your first witness?

The Clerk informs me that there is only one book in the records.

MR. BROOKES: Your Honor, in the stipulation of facts, my attention has been called to the circumstances, that the phraseology of the stipulation of facts requires a ruling of the Court admitting into evidence and not merely a stipulation of the parties, I am afraid, because of this, in paragraph 38 of the stipulation of facts, the one which identifies the exhibits, it uses this language there: "May be introduced into evidence as a part of this stipulation of facts, the following exhibits—" and in it it identifies them all.

Your Honor, the parties have stipulated that the stipulation of facts and the exhibits which were a part of it may be introduced into evidence. May I ask Your Honor for a ruling that they have been admitted into evidence, including the exhibits?

THE COURT: So ordered. This will be admitted into evidence as Plaintiff's next in order. It will be Plaintiff's 4, A, B, C, et cetera.

MR. BROOKES: Thank you, Your Honor.

(Thereupon the aforementioned items were marked and received as Plaintiff's Exhibits 4, A, B, C, in accordance with Paragraph 38 of Stipulation of Facts)

Supreme Court, U. S.
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NOV 30 1977
MICHAEL RODAK, JR., CLERK

IN THE

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On Appeal from the Court of Appeal of California,
First Appellate District

BRIEF OF THE FINANCIAL EXECUTIVES INSTITUTE AND THE TAX EXECUTIVES INSTITUTE, INC., AS AMICI CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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BRIEF OF THE FINANCIAL EXECUTIVES INSTITUTE AND THE TAX EXECUTIVES INSTITUTE, INC., AS AMICI CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

This brief is submitted with the written consent of counsel to both parties filed with the Clerk of the Court.

INTEREST OF THE AMICI CURIAE

Financial Executives Institute ("FEI") is a non-profit, individual membership, professional organization composed of approximately 10,000 corporate executives who are responsible for the development of fi-

nancial policy and the administration of the financial affairs of some 5,000 companies, large and small, in the United States, Canada and Puerto Rico. The companies with whom FEI's members are associated represent a broad cross-section of American business and industry and they conduct a significant portion of the nation's interstate commerce.

One of the primary objectives of FEI is to provide a means for its members to make joint studies and recommendations on matters of broad financial significance, including developments in state and local taxation which significantly affect business or the environment in which it operates.

The specific interest of FEI in this case is that the decision of which review is now sought constitutes a serious inroad upon the well established rules that a state may not tax out-of-state corporations upon income not in any way attributable to activities within the taxing state, and that common ownership alone does not justify state taxation of an in-state corporation upon the basis of income earned by an out-of-state, independent, affiliated corporation.

In view of the essential role these constitutionally based principles have played in the proper growth and development of the nation's interstate commerce, the potential consequences of the present decision are of the gravest concern to FEI, the business community, and the nation as a whole.

Tax Executives Institute, Inc. ("TEI") is a nonprofit organization whose membership consists of approximately 3,200 corporate and other business executives, managers and administrators who are responsible for the administration of the tax affairs of their

employers. TEI's membership represents approximately 1,800 business organizations, nearly all of which engage in interstate commerce. A prime objective of TEI is to promote uniform enforcement of taxes throughout the nation and thereby to minimize the costs of administration and compliance for the benefit of government and taxpayers alike.

TEI represents persons who bear the responsibility and burden of complying with the decision of the Court of Appeal of California which is at issue in this case. In view of the administrative difficulties and uncertainties created by that decision, TEI and its members have a direct and special interest in the outcome of this case.

ARGUMENT

This case presents an issue of pervasive importance under the Commerce and Due Process Clauses—whether a state may apply the so-called unitary approach and levy tax by reference to the combined net income of an affiliated group of corporations, even though only a single member of the group does business within the state, and even though that member's income is neither more nor less than it would have been in the absence of the affiliation. Here, in imposing its franchise tax (measured by net income) on appellant Chase Brass & Copper Co. ("Chase"), which operates in California, California has included in the tax base net income earned by Chase's parent, Kennecott Copper Corporation ("Kennecott"), and other Kennecott companies, which do not operate in California. It has done so solely by reason of the fact that Kennecott owns the controlling interest in Chase and the other companies, for the trial court specifically found (J.S.

App. A at 7 [1]) that the income-earning activities of Chase and the other corporations were at all times separate and distinct, and that Chase's business activities were not so inter-related with the business activities of the other out-of-state corporations "as to make possible the earning of income by Chase or any of the others . . . not properly reflected on each's separate books of accounts." The trial court further found (*Ibid.*) that:

> Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership.[2]

Only last Term this Court reaffirmed that the Commerce Clause limits the power of states to tax activities in interstate commerce, *see Boston Stock Exch.* v. *State Tax Comm'n,* 429 U.S. 318 (1977), and announced that the constitutionality of a state tax is to be determined not by resort to formalistic labels, but by whether the tax produces a forbidden effect, *Complete Auto Transit* v. *Brady,* 430 U.S. 274, 288 (1977). To pass constitutional muster under the Due Process and Commerce Clauses, a direct tax on interstate activity must be justified by a substantial nexus between the activity taxed and the taxing state, must be fairly apportioned, must not discriminate against interstate commerce, and must be fairly related to services provided by the taxing state. *Id.,* at 279-287. California's tax at issue here is constitutionally impermissible on all of these grounds. If allowed to stand, the decision below sustaining this tax provides a ready method by which states may circumvent the Due Process and Commerce Clause protections which have been essential in facilitating the growth of the nation's economy in an environment complicated by the varying and often conflicting tax systems of the fifty states. The attempt by California to reach the combined incomes of the Kennecott affiliated corporations is typical of the recent pattern of state efforts to stretch taxing powers in order to reap an ever-larger share of the profits of multicorporate entities.[3] Because so much of the nation's interstate commerce is conducted by multicorporate entities, it is vitally important that the Court note jurisdiction in this case in order to clarify the constitutional limitations upon a state's power to tax such entities.

1. The effect of applying California's unitary allocation formula in this case—the taxation of income earned in other states—has been uniformly forbidden by the decisions of this Court, "both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due." *Norfolk & W. Ry.* v. *Missouri State Tax Comm'n,* 390 U.S. 317, 325 (1968). This Court

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[1] "J.S. App." references are to Appendices to the Jurisdictional Statement.

[2] These findings distinguish this case from other apportionment cases in which the income-earning activities of corporations, or divisions of the same corporation, are inter-related. *See, e.g., Butler Bros.* v. *McColgan,* 315 U.S. 501, 507-10 (1942).

[3] Recent state efforts to utilize overly favorable apportionment formulas in order to increase revenues from the taxation of interstate activities are not limited to the multicorporate situation. *See, e.g., Moorman Mfg. Co.* v. *Bair,* No. 77-454, *probable jurisdiction noted,* November 14, 1977.

has unequivocably held that, "[a] State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders.'" *Id.* (citation omitted). *See also, Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123 (1931); *Wallace* v. *Hines,* 253 U.S. 66 (1920). The applicability of this long established restriction to the tax imposed here, and the wisdom of continuing to apply this restriction, are inescapable.

The decision of the Court of Appeal in this case sustains a wholly extra-territorial tax on out-of-state income earned by out-of-state corporations. Unless reversed by this Court, it means that henceforth with respect to the great majority of multicorporate entities the states are no longer subject to the constitutional limitation that they may tax only activities and values within their borders. It thus removes the most fundamental safeguard against multiple taxation of interstate business.[4]

2. Equally important, by arbitrarily imposing upon corporations with out-of-state affiliations a substantial tax burden not imposed upon corporations without such affiliations, California is discriminating against multi-

[4] The danger of multiple taxation is all too clear in this case. California included in Chase's tax base approximately $5,000,000 of out-of-state income earned by one Kennecott subsidiary even though that subsidiary had already paid the State of Rhode Island tax on its entire net income. Similarly, the State of Utah had imposed its own version of the "unitary" business concept upon Kennecott, but the Court of Appeal of California merely stated: "[T]he Utah decision is not controlling as to this court; also, it is based on the application of separate accounting principles to the unitary business, which are contrary to the laws of this state. . . ." J.S. App. D at 39-40.

corporate entities and against the interstate commerce of which those enterprises are a significant part. This Court has repeatedly held that no state may, consistent with the Commerce Clause, "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." *Boston Stock Exch.* v. *State Tax Comm'n, supra,* at 329, quoting *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 458 (1959). *See also, Halliburton Oil Well Co.* v. *Reily,* 373 U.S. 64 (1963); *Nippert* v. *Richmond,* 327 U.S. 416 (1946); *I.M. Darnell & Son* v. *Memphis,* 208 U.S. 113 (1908). Nor may any state "build up its domestic commerce by means of unequal and oppressive burdens upon the industry and business of other states." *Guy* v. *Baltimore,* 100 U.S. 434, 443 (1880). Here, the discrimination is obvious because multicorporate entities based entirely within California are not subject to the state's "unitary" or "combined reporting" method.[5]

3. The tax upon the income of Chase's corporate affiliates also offends the Due Process Clause because it is in no way justified by any nexus between the taxing state and the income-producing activities of the foreign corporations or by any services offered by California to out-of-state multicorporate entities. Any conclusion that the incomes of Chase and its affiliates are "unitary" in the sense of being inter-related finds no support in the facts of this case as stipulated by the parties and found by the trial court. Whatever the justification for this method of apportionment in other situations, utilization of the unitary method in this

[5] *See Handlery* v. *Franchise Tax Board,* 26 Cal. App. 3d 970, 103 Cal. Reptr. 465 (1972), *appeal dismissed,* 410 U.S. 921 (1973).

case flies in the face of the constitutional requirement that state taxes be fairly apportioned to reflect income-producing activities within the state.

Nor can the result reached by the Court of Appeal below be justified by the convenient incantation that it is a permissible "rough approximation" of the income produced by Chase in California.[6] Application of the formula in this case resulted in a seven-fold multiplication of Chase's income for the three-year taxable period. This Court rejected a similar "rough approximation" in the *Norfolk & W. Ry.* case, *supra,* where the allocation method applied resulted in a multiplication of the value of the taxpayer's property by only as much as two and one-half. In doing so, the Court stated (390 U.S. at 327):

> Our decisions recognize the practical difficulties involved [in apportionment] . . . but our cases certainly forbid an unexplained discrepancy as gross as that in this case. Such discrepancy certainly means that the impact of the state tax is not confined to intrastate property even within the broad tolerance permitted. The facts of life do not neatly lend themselves to the niceties of constitutionalism; but neither does the Constitution tolerate any result, however distorted, just because

[6] The Court of Appeal placed reliance on the "rough approximation" language of *International Harvester Co.* v. *Evatt,* 329 U.S. 416 (1947), to support its decision. That case is inapposite to this one, however, because it involved a specific finding that the state tax was not being imposed upon sales made outside the state and that the purpose of the formula was to arrive at a fair value of the intrastate business of a single taxpayer. *Id.*, at 421-423. There is no indication in *International Harvester* that the Court intended to allow a state to use "rough approximation" to tax the extra-territorial incomes of separate corporate entities not otherwise subject to the state's taxing powers.

> it is the product of a convenient mathematical formula. . . .

4. Finally, the decision of the California Court of Appeal, extended to its logical conclusion, would allow California to tax corporations operating within its boundaries upon the basis of income earned outside the United States by their foreign affiliates. Indeed, California has already applied its combined reporting requirement to Canadian companies operating within California (although not in this particular case). The logical extension of California's application of the unitary business concept therefore threatens to interject the states improperly into the delicate area of international trade and business relations.[7]

If permitted to stand, the decision of the Court of Appeal of California will impede the orderly growth of

[7] This problem was noted in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the United States House of Representatives, which recommended:

> In keeping with the basic structure of our Federal System, the Committee is of the view that international tax policy should be formulated by the Federal Government and not by individual states.
>
> • • • • • •
>
> Likewise, no State would be allowed to require that such income [from sources outside the United States] be included in the consolidated income of a multicorporate enterprise for apportionment purposes.
>
> H. Rep. No. 952, Vol. 4, p. 1155, 89th Cong., 1st Sess. (1965).

Although this case does not directly involve the taxation of income earned outside the United States, the foregoing consideration illustrates the grave danger of allowing the states to tax extra-territorial activities under the guise of seeking to apportion the income of multicorporate enterprises.

interstate commerce by creating an atmosphere of uncertainty respecting the power of the states to tax multicorporate entities. The decision renders impossible a fair apportionment of revenue among the states as each will compete for a larger share without regard to the traditional restriction that they may not tax activities and values outside their borders. Immediate correction by this Court is required if this result is to be avoided.

CONCLUSION

For the foregoing reasons it is submitted that the decision in this case raises substantial and serious questions under the Commerce and Due Process Clauses of the Constitution; presents issues of great importance to the nation's commerce; and is patent in its error. *Amici curiae* accordingly urge the Court to note probable jurisdiction and grant a plenary hearing on the merits.

Respectfully submitted,

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee*.

On Appeal From the Court of Appeal of California,
First Appellate District

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

This brief *amicus curiae* is filed on behalf of the Committee on State Taxation (COST) of the Council of State Chambers of Commerce pursuant to the consent granted by both parties. Copies of their letters of consent are reproduced in Appendix A.

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, is reported at 70 Cal. App. 3d 457, 138 Cal. Rptr. 901 (1977). Cross petitions for rehearing were denied by the Court of Appeal and cross petitions for hearing in the California Supreme Court were denied by that Court on August 11, 1977.

INTEREST OF AMICUS CURIAE

The Council of State Chambers of Commerce (COUNCIL), organized in 1931, consists of 33 chambers of commerce (29 state and 4 regional chambers). The Committee on State Taxation (COST), one of the COUNCIL's four advisory committees, consists mainly of corporations which conduct a substantial portion of the multistate and interstate business in the United States. One of COST's principal activities has been to work toward developing fair and equitable national standards in the income allocation and apportionment aspects of state taxation.

Member companies of COST, therefore, are representative of that part of the nation's business sector which is most directly affected by state taxes, including corporate franchise taxes imposed upon multistate and interstate business operations. COST is obviously and vitally interested in cases such as this one which present issues significantly affecting the uniformity, certainty and fair apportionment of taxes in each of the fifty states.

The particular interest of COST in this case is that it presents the fundamental and far-reaching issue of the extent of a state's power under the Due Process

and Commerce clauses to tax corporations operating within the state upon the basis of income earned outside of the state by independently operated out-of-state affiliates.

At the present time, 12 corporate members of COST have similar issues in the process of adjudication before the administrative agencies and the courts of California.

This Court's review of this case and its establishment of constitutional standards for state taxation of multistate businesses are urgently needed for the orderly growth of interstate commerce in the United States. They are also needed to provide a reasonably consistent and fair system of taxation throughout the nation which will allow each state to receive its just share of the total tax contribution of the nation's business sector. Finally, such review is needed to protect the constitutional rights of taxpayers in this era of rapidly increasing state and local revenue needs and the states' tendency toward delegation of the taxing authority among numerous local government units.

This brief seeks (1) to show that the decision of the Court of Appeal of California in this case is directly repugnant to longstanding judicial interpretation of the Due Process and Commerce Clauses of the Constitution and (2) to show the wide and adverse effect upon multistate business operations that decision will have, unless this Court undertakes to resolve the question presented.

ARGUMENT

The crux of the decision of the Court of Appeal of California in this case is that the state's franchise tax has been properly imposed upon Chase Brass and Cop-

per Co. (Chase) although measured in part by income earned by independent corporate affiliates of Chase, which income is in no way attributable to business operations or property owned within the State of California. It is a tax based, therefore, substantially upon extraterritorial income of corporations not subject to tax in California, which this Court traditionally has regarded as an undue burden upon interstate commerce under the Commerce Clause and a violation of the "nexus" and "minimum connection" requirements of the Due Process Clause.

The constitutional test established by the Court holds that a state tax on an interstate enterprise may not be sustained where the tax reaches activities carried on beyond the borders of the state. Where a state income tax reaches profits which are in no sense attributable to transactions within its jurisdiction, the Court has held the tax to be constitutionally invalid. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123 (1931).

California's application in this case of the "combined reporting" or "unitary" approach in the taxation of affiliated corporations violates this fundamental standard. As more fully described in the Jurisdictional Statement of Appellant, it includes within the basis for determining the amount of Chase's franchise tax liability the income earned by Kennecott Copper Corporation (Kennecott) and some of its subsidiaries on the sole ground that Kennecott owns a controlling stock interest in Chase and the other subsidiaries. In approving this approach the California court disregarded the facts that (1) neither Kennecott nor any of the subsidiaries, other than Chase, does any business in California, (2) Chase is operated independently from Kennecott and its affiliates and (3) all dealings

between Chase and Kennecott are conducted at arms' length and all purchases by Chase of Kennecott products are at standard and well-established market prices. In other words, this is a case where the evidence, coupled with the application of standard and generally accepted accounting principles, conclusively demonstrates that the income of Chase's independent affiliates is not in any way attributable to Chase's operations within the State of California. By disregarding these facts in imposing the tax in this case, California is attempting to tax Chase on the extraterritorial operations of its affiliates in violation of established constitutional standards.

Such extraterritorial taxation is precluded by the requirement that a state corporate net income tax be fairly and equitably apportioned to local activities or property within the taxing state. *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959). In three recent decisions of this Court affecting the jurisdictional reach of the states to tax interstate business, proper apportionment has been an essential element. *Standard Pressed Steel Co.* v. *Department of Revenue,* 419 U.S. 560 (1975); *Colonial Pipeline Co.* v. *Traigle,* 421 U.S. 100 (1975); *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977).

Thus, in *Colonial Pipeline,* this Court subscribed to earlier decisions which "have sustained nondiscriminatory, properly apportioned state corporate taxes upon foreign corporations doing an exclusively interstate business when the tax is related to a corporation's local activities and the State has provided benefits and protections for those activities for which it is justified in asking a fair and reasonable return." 421 U.S. at 108. In that case, the "fairly apportioned and nondiscrimi-

natory levy", 421 U.S. at 114, did not offend the Commerce Clause. In *Complete Auto Transit,* the attention of this Court was directed to the possibility that the tax in question might easily be tailored to single out interstate businesses and subject them to effects forbidden by the Commerce Clause. It was therein stated that: "Any tailored tax of this sort creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." 430 U.S. at 288, n. 15.

Constitutionality turns on the presence of a direct and demonstrable relationship between the taxing jurisdiction and the net income of the person being taxed. The benefits and protection afforded by the taxing jurisdiction to the taxpayer are the constitutional premise upon which the validity of the tax reposes. Both elements are missing in the case at hand.

This issue is of national importance since it potentially affects every state and every group of affiliated corporations whose members operate in different states. As noted by Congressman Rodino in his June 11, 1969 statement before the Committee on Rules of the U.S. House of Representatives:

> "The number of jurisdictions taxing [the several hundred thousand companies engaged in interstate commerce] is staggering. There are in effect at the state level 42 sets of corporate income tax laws, 43 sales and use tax laws, 37 capital stock laws and 8 gross receipts tax laws of general applicability. In addition, to compound further the chaos and confusion, business taxes are rapidly proliferating on a local level—with sales taxes already imposed by about 3,000 localities, gross receipt taxes by over 1,000 and corporate income taxes by more than 200 local governments."

The potential effect of the *Chase* case extends to all of the state and local taxing jurisdictions employing taxes measured by income, and, of course, to any new state or local levies of this type.

The Multistate Tax Commission is urging the States to utilize combined reports. See Resolution No. 3 adopted by the Multistate Tax Commission on May 4, 1977 which is reproduced in Appendix B of this brief. A principal objective of the joint audit program of the Multistate Tax Commission is to find a unitary business relationship between affiliated corporations and encourage the use of combined reports. Cappetta, "Joint Audit Program of the Multistate Tax Commission," N.Y.U. 33rd Inst. on Fed. Tax. 961, 967-73 (1975).

Notwithstanding the statement made in the oral argument before the Court on October 11, 1977 in *United States Steel Corp. et al* v. *Multistate Tax Commission,* Docket No. 76-635, prob. juris. noted, 427 U.S. 1088 (1977), by William Dexter, attorney for Appellees that: "There is no audit that has ever been conducted by the Commission that touches upon the subject matter in the United Kingdom Treaty" (p. 28 of the Transcript),[1] there is no doubt but that the Commission has performed audits on a combined return basis. *Montana Department of Revenue* v. *The American Smelting and Refining Co.,* —— Mont. ——, 567 P.2d 901 (1977), U.S. Sup.Ct.Dkt. No. 77-658 (docketed Nov. 7, 1977).

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[1] Article IX of the Treaty would prevent states from including United Kingdom parents and their affiliates in a combined report

The full extent of the burden upon national commerce imposed by the decision in this case is substantially compounded by the often discriminatory taxation of affiliated corporations. This is illustrated by the fact that while California in this case has treated a multicorporate enterprise on a unitary basis to increase the taxpayer's tax obligation, Utah refused to balance the scales by applying that doctrine to the same taxpayer where it would result in a corresponding reduction in the tax obligation. (See *Kennecott Copper Corp.* v. *State Tax Commission,* 27 Utah 2d, 119, 493 P. 2d 632 (1972), *appeal dismissed,* 409 US 973, *rehearing denied,* 409 U.S. 1093 (1972).[2] The impact of such diversity in state taxation today is reflected in the current high levels of state corporate net income tax rates. For example, Kennecott Sales will pay tax on its entire net income to New York State and New York City at 1977 rates of 12% and 10.5%, respectively. If some portion of this net income is shifted to California by reason of that state's combined report procedures to that extent it will be subject to an additional tax of 9%.[3]

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of a related company doing business in such states. Thus, the subject matter of the Treaty does concern combined returns.

[2] Refusal to give plenary consideration to the Kennecott case and this case when first appealed prompted one commentator to say that this Court "has for the most part remained on the sidelines" with respect to the issue of what constitutes fair apportionment. W. Hellerstein, "State Taxation of Interstate Business and the Supreme Court," 1974 Term: *Standard Pressed Steel and Colonial Pipeline,* 62 Va. L. Rev. 149 (1976). The reticence may account in part for the fierce opposition by state tax administrators to any federal legislation providing uniform standards. Hearings by the Subcommittee on State Taxation of Interstate Commerce of the Senate Committee on Finance, 93rd Cong., 1st Sess. (1973).

[3] Some indication as to the extent of the extraterritorial taxation

The problem of discriminatory application is exacerbated by reason of the lack of statutory provisions spelling out the circumstances under which the method can and must be used—leaving this decision to the absolute discretion of the state collecting agencies and the absence of definitive regulations. California has issued a 15-page booklet that simply paraphrases the wording of certain decisions of the courts as to what constitutes a unitary business (the determinative factor with respect to combined reporting in California); the Multistate Tax Commission uniform regulations adopted by a number of states provide that nothing in the regulations precludes the use of a combined report; and most states have no regulations at all. Uncertainty as to the proper method for members of a multicorporate, interstate enterprise to determine their state tax liabilities is compounded by the fact that a number of state tax administrators are requiring combined reports where there is no specific statutory authority for requiring such reports, on the ground that the general apportionment provisions of the tax law are broad enough to require the combining of the "unitary" business income and factors of the affiliated group. Peters, "State Income Tax Problems of Interstate Business", N.Y.U. 33rd Inst. on Fed. Tax 899, 931-40 (1975). The elusive nature of the unitary concept is eloquently expressed by Professor Gary Boren in the following words:

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problem in this one state may be found in the remarks of Martin Huff, Executive Officer of the California Franchise Tax Board to the effect that if California were prohibited from including the net income and factors of non-United States corporations in combined reports, it would reduce the state's revenues by about $125 million. *L.A. Times,* Oct. 17, 1977. While such an estimate is highly speculative, it reflects the current position of the Franchise Tax Board staff.

> "The tests formulated by the courts to determine when a business is unitary have been all but useless. In addition, it is difficult to glean from the opinions any consistent pattern of analysis in ascertaining the applicability of separate accounting." [18 U.C.L.A. L. Rev. 478, 532 (1971)].

Indeed, the tests have become so meaningless and their application so subjective that the person most responsible for their formulation and acceptance in California tax law has proposed that they be dispensed with altogether and that controlling ownership of stock be the determining factor with respect to the requirement of a combined report.[4]

The Attorney General of California joined Kennecott in asking this Court to review the Utah decision and in its brief amicus curiae stated that harmonization of such conflicting methods of apportioning net income among the states for taxation was a substantial federal question warranting this Court's intervention. Brief of the State of California as Amicus Curiae, pp. 3, 5, 10. It is universally recognized that there is a need for uniform application of the combined report concept by those states choosing to utilize it.

The problem was specifically noted in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the U.S. House of Representatives, Vol. 4, H. Rep. No. 952, 89th Cong., 1st Sess. 1155 (1965), as follows:

> "The present 'unitary business' rules provide vague and sometimes unevenly administered standards for determining when the income of a multicorporate enterprise should be treated as a whole."

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[4] Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices," 42 J. Tax. 106 (1975).

The Report goes on to state that the establishment of a national standard in this area "will result in a significant measure of relief from the multiplicity and diversity of the present system." *Id.* at 1205-06. The need for a federal review of the impact of conflicting state laws on interstate commerce has been more recently expressed by Senator Mathias (123 Cong. Rec. S 1623, October 4, 1977) as follows:

> "Our Constitution was written as a compact between States willing to trade short-run gains for long-term progress in an orderly Federal system of free-flowing commerce.
>
> "Today that system is not functioning as efficiently as it should. A major obstacle to interstate commerce lies in the complex and often conflicting local tax rules which confront firms in interstate commerce. These rules harm both business and our state and local governments—and, in the end, deprive all our citizens of the efficiency which leads to lower prices and the tax revenue which finances government services."

Finally, in its study of this problem the House's special subcommittee implicitly anticipated the need for this Court's ultimate resolution of the many conflicts and uncertainties in this area when it stated:

> "First of all, the [unitary business or combined report] concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on an in-State corporation. *This may arise as a constitutional question* or in terms of the limitations on State taxing power imposed by Public Law 86-272."
>
> "In the latter case, the question is whether a State may require a company within its taxing jurisdic-

> tion to include in the measure of its tax income from an affiliate which is covered by an exemption in that statute. This question is unsettled, and as a result at least one state, California—the leading exponent of the combined report concept—anticipates that it will have to litigate the issues involved." [Emphasis added; footnote omitted; H. Rep. No. 1480, 88th Cong., 2d. Sess., vol. 1, p. 245. (1964)]

The serious constitutional problems concerning state taxation of affiliated corporations can be resolved only by this Court. The courts of the several states are ever more frequently being confronted with cases involving the federal issues raised by this appeal and their conflicting decisions are irreconcilable. *Skelly Oil Co.* v. *Commission of Taxation,* 269 Minn. 351, 131 N.W. 2d 632 (1964); *Woolworth Co.* v. *Director,* 45 N.J. 466, 213 A. 2d 1 (1965); *Interstate Finance Corp.* v. *Wisconsin,* 28 Wis. 2d 262, 137 N.W. 2d 38 (1965); *Coca Cola Company* v. *Department of Revenue,* 271 Ore. 517, 533 P. 2d 788 (1975); *In re Wurlitzer Company* v. *State Tax Commission,* 35 N.Y. 2d 100, 315 N.E. 2d 805 (1974); *Annel Holding Corp.* v. *State Tax Commission,* 355 N.Y.S. 2d 237 (1974); *Universal Manufacturing Corp.* v. *Brady,* 320 So. 2d 784 (Miss. 1975); *Montana Department of Revenue* v. *The American Smelting and Refining Co., supra.* The result has been a widening disagreement over the constitutional restraints on the states' power to tax affiliated corporations and an ever-increasing diversity of patterns of state taxation where uniformity is needed to prevent over or under taxation of such corporate groups. See Shannon, "State Income Taxes—Living with Complexity," 30 Nat. Tax J. 339 (1977). The result of this conflict and lack of uniformity is uncertainty as to

the rights of affiliated corporations which will impede the orderly growth of national commerce and promote an unfair apportionment of revenue among the states. The magnitude of these problems inevitably increases as state revenue needs grow (state taxes rose 14.1% or $12 billion, in the twelve-month period ending March 1977), as the number of taxing authorities is increased by delegation of state taxing authority to local governments, and as the states increasingly look beyond their borders to meet their tax needs.

CONCLUSION

Amicus Curiae submits that the *Chase* case reflects an arbitrary assumption of state taxing authority which violates established constitutional limitations. The case affords the basis for a needed review by this Court of the right of a state or local government to base a tax upon income derived outside its borders by corporations not subject to its jurisdiction through the application of presumptions in the face of facts to the contrary. Such a review is of high interest to the proper economic development of the United States and to business done within it.

Respectfully submitted,

GEORGE S. KOCH
Counsel

Attorney for the Committee on State Taxation of the Council of State Chambers of Commerce

APPENDIX

APPENDIX A-1

STATE OF CALIFORNIA

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November 2, 1977

George S. Koch, Esq.
Counsel
Committee on State Taxation
Council of State Chambers of Commerce
1028 Connecticut Avenue, Suite 1018
Washington, D.C. 20036

Dear Mr. Koch:

Re: Chase Brass and Copper Co., Incorporated v. Franchise Tax Board of the State of California, No. 77-582, O.T. 1977

You have our consent to file an amicus curiae brief in support of appellant's jurisdictional statement in the above matter.

Very truly yours,

EVELLE J. YOUNGER
Attorney General

/s/ TIMOTHY G. LADDISH
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APPENDIX A-2

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November 1, 1977

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Washington, D.C. 20036

Re: Chase Brass & Copper Co. v.
Franchise Tax Board
No. 77-582, October Term, 1977,
United States Supreme Court

Dear Mr. Koch:

Replying to your letter of October 27th, I am glad to consent to your filing an amicus curiae brief in this case, in support of the position taken in our jurisdictional state-

ment that there are substantial federal questions justifying plenary consideration.

Sincerely yours,

/s/ VALENTINE BROOKES
/s/ VALENTINE BROOKES
Attorney for Appellant,
Chase Brass & Copper Co., Inc.

VB:chp
cc: Eugene Bock, Esquire

APPENDIX B

RESOLUTION #3

BE IT RESOLVED THAT:

1) It is the official policy of the Multistate Tax Commission that the unitary business concept is appropriate for attributing income with respect to all businesses affected by the Uniform Division of Income for Tax Purposes Act; and that

2) It is appropriate on a worldwide as well as a domestic basis regardless of whether the parent or some or all of the subsidiaries are located outside or inside the United States; and that

3) The Commission recommends that each state pursue the policy recommended in this resolution to the full extent permitted by its laws; and that

4) Where a state's laws do not permit complying with this recommendation, efforts be made to amend those laws in order to effect such a result.

MULTISTATE TAX COMMISSION

May 4, 1977, Denver, Colorado

Annual Meeting

Supreme Court, U.S.
FILED
DEC 9 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

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ON APPEAL FROM THE COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT

BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA

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IN THE

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FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee.*

ON APPEAL FROM THE COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT

BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

With consent of the parties, the National Association of Manufacturers of the United States of America respectfully submits this brief as *amicus curiae* in support of Appellant's Jurisdictional Statement.

INTEREST OF THE AMICUS CURIAE

The National Association of Manufacturers of the United States of America (NAM) is a non-profit voluntary business organization organized as a membership corporation under the laws of the State of New York. It is composed

of more than 12,500 manufacturing and related concerns located throughout the United States. NAM's members represent a substantial proportion of the nation's industrial output and employ roughly eighty-five percent of all employees employed in manufacturing nationwide. The majority of these concerns engage in interstate commerce to some degree.

This case presents a fundamental and far-reaching issue. The extent of a state's power to tax corporations operating within that State, where the basis of the tax is income earned outside the state by independently operated out-of-state affiliates, is a substantial question under the Due Process and Commerce Clauses of the U.S. Constitution.

NAM's member companies are representative of that part of the nation's business sector which is most directly affected by state taxation, including corporate franchise taxes, upon multistate and interstate business operations. NAM is vitally interested in cases such as this which present significant constitutional issues affecting the uniformity, certainty and fair apportionment of taxes on income, or based on income, in each of the fifty states.

SUMMARY OF ARGUMENT

The result of the decision of the Court of Appeal of California in this case is that it allows California to impose a franchise tax upon Chase Brass and Copper Co. (Chase) measured by income earned by independent corporate affiliates of Chase, which income is in no way attributable to business operations within the State of California. It is, therefore, a tax based upon income earned outside the state. This Court has traditionally regarded such taxes as undue burdens upon interstate commerce under the Commerce Clause and violations of Due Process requirements.

The constitutional test established by this Court requires that a state tax on interstate enterprise may not be sustained where the tax reaches activities carried on beyond the borders of the state. Where a state income tax reaches

profits which are in no sense attributable to transactions within its jurisdiction, this Court has held the tax to be constitutionally invalid. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123 (1931); *Norfolk & Western R. Co.* v. *Missouri,* 390 U.S. 317 (1968).

Compounding of tax obligations results where some states practice the unitary apportionment method because other states do not allow the taxpayer corresponding reductions in tax obligations. Single-state taxpayers thereby derive an unfair competitive advantage over multistate taxpayers who are thus burdened because of their interstate commerce activities.

ARGUMENT

I. The Due Process and Commerce Clauses Protect Multistate Taxpayers From Tax Apportionment Schemes Which Result in "Palpably Disproportionate Results."

This Court has regularly applied the Due Process Clause of the Fourteenth Amendment to the U. S. Constitution so as to prevent the taxation by one state of property located in another state. *Frick* v. *Pennsylvania,* 268 U.S. 473 (1925); *Looney* v. *Crane Co.,* 245 U.S. 178 (1917); *Delaware, L & W.R. Co.* v. *Pennsylvania,* 198 U.S. 341 (1905). The Due Process Clause has often been satisfied where apportionment taxation methods were appropriate and not an undue burden on interstate comerce. *Pullman's Palace Car Co.* v. *Pennsylvania,* 141 U.S. 18 (1891); *Union Refrigerator Transit Co.* v. *Lynch,* 177 U.S. 149 (1900). The Due Process Clause may also allow the reasonable use of unitary apportionment as an acceptable taxation procedure "[u]nless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege." *International Harvester Co.* v. *Evatt,* 329 U.S. 416, 422-423 (1947).

This long history of constitutional controls over interstate taxation methods has applied equally to income as well as real and personal property. *Hans Rees' Sons* v.

North Carolina, 283 U.S. 123 (1931); *Norfolk & Western R. Co.* v. *Missouri*, 390 U.S. 317 (1968). A franchise tax determined by income is not distinct from a tax on income because tax questions are determined on matters of substance and not form. *See Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 120 (1920). The taxpayer carries the burden of showing that the income attributed to it under a state's apportionment formula is not reasonably attributed to business operations within the taxing state.

When applied to the factual circumstances presented in Chase, the unitary approach used by California produced such a disproportionate result that Chase was taxed on an apportioned national net income of $102,627,592 for 1955 when, in fact, Chase actually lost $2,370,010 that year due to a flood of its major processing plant. Further, for the three years in question, the California unitary apportionment approach derived inflated net income to sales ratios of 38%, 51% and 58%. These results, discussed and documented in Appellant's Jurisdictional Statement, are patently absurd.

Clearly, the apportioned net income amounts attributed to Chase and taxed under the California unitary formula are usurped by California from Chase's independent corporate affiliates. Even though they do no business in California, California reaches its tax arm into interstate commerce and taxes the affiliates' property, in the form of ~~their~~ their income. The gross exaggerations of Chase's income produced by the California scheme cannot be excused under the "rough approximation" language of *International Harvester* (*Supra* at 120) relied upon by the court below. Chase's attributed income under California's unitary apportionment scheme simply cannot be reasonably attributed to Chase's operations in California.

It is the opinion of the *amicus curiae* that the California unitary apportionment method of determining state franchise taxes simply will not withstand the scrutiny of this Court.

II. If Left Unchecked, The Undue Burden on Interstate Commerce of Unitary Apportionment Will Compound Taxation of Multistate Corporations, to the Competitive Advantage of Single-State Enterprises.

The potential effect of the Chase decision extends to all state and local government taxing jurisdictions by encouraging them to adopt this approach as a means to supplement failing tax revenues.

The full extent of California's burden upon interstate commerce imposed by the decision in this case will be substantially compounded by the often discriminatory taxation of multistate enterprises. While California in this case has treated a multicorporate enterprise on a unitary basis so as to increase the taxpayer's tax obligation in California, other states have refused to allow the same taxpayer a corresponding reduction in their tax obligation in those states. *See Kennecott Copper Co.* v. *State Tax Comm.*, 118 Utah 140, 221 P. 2d 857 (1950); *Kennecott Copper Corp.* v. *State Tax Comm.*, 5 Utah 2d 306, 301 P. 2d 562 (1956). Single-state taxpayers will derive an unfair competitive advantage for they will not be encumbered with such taxes.

The problem of compounding tax obligations was specifically noted by the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the U.S. House of Representatives. That committee noted that "the present 'unitary business' rules provide vague and sometimes unevenly administered standards for determining when the income of a multicorporate enterprise should be treated as a whole." H.R. Rep. No. 952, Vol. 4, p. 1155, 89th Cong., 1st Sess. (1965). The report goes on to state that the establishment of a national standard in this area "will result in a significant measure of relief from the multiplicity and diversity of the present system." *Id.* at 1205-06.

In its study of this problem the House's special subcommittee actually anticipated the need for this Court's ultimate

resolution of the many substantial questions and uncertainties in this area when it stated:

> First of all, the [unitary business or combined report] concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on an in-State corporation. This may arise as a constitutional question or in terms of the limitations of State taxing power . . .

H.R. Rep. No. 1480, Vol. 1, p. 245, 88th Cong., 2d Sess. (1964).

The serious constitutional problems concerning state taxation of multicorporate enterprises have not been resolved by the Congress. The issues can be resolved only by this Court. The courts of the several States will be frequently confronted with cases involving these same federal issues. Without this Court's guidance, a widening disagreement over the existence of constitutional restraints on the States' power to tax multistate business enterprises will certainly result.

Unless this Court reverses the decision below, the orderly growth of national commerce will be impeded. Unfair apportionment of revenue among the states will logically follow. Interstate commerce will be burdened with compounded taxes which will have the full effect of tariff barriers between states. Moreover, the magnitude of these problems will inevitably increase as state revenue needs grow.

CONCLUSION

It is respectfully submitted that the Chase case reflects an arbitrary extension of state taxing authority in direct contravention of established constitutional limitations. The case affords the basis for a needed reaffirmation by this Court of the limitations on the power of a state to base a tax on income derived outside its borders.

The decision of the court below must be reversed.

Respectfully submitted,

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